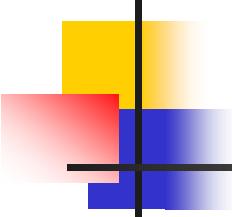


The State of the Economy and Prospects for Tax Revenue in Tennessee

presented to
Tennessee State Funding Board
Nashville, Tennessee
December 15, 2006

by
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The State of the Economy and Prospects for Tax Revenue in Tennessee

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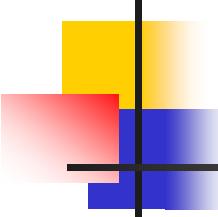
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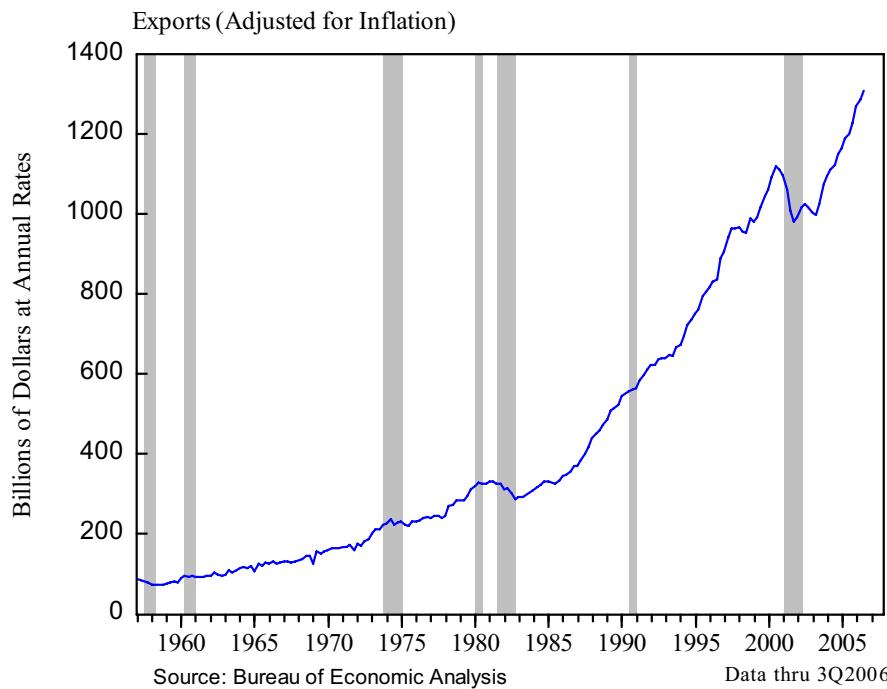
Tennessee Economic Outlook

Outlook for State Revenue
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The U.S. Cycle in Perspective

The U.S. in the Global Economy



The U.S. Business Cycle in Perspective

Recovery in Technology Spending Still Dominates the Investment Spending Picture

Business equipment and software

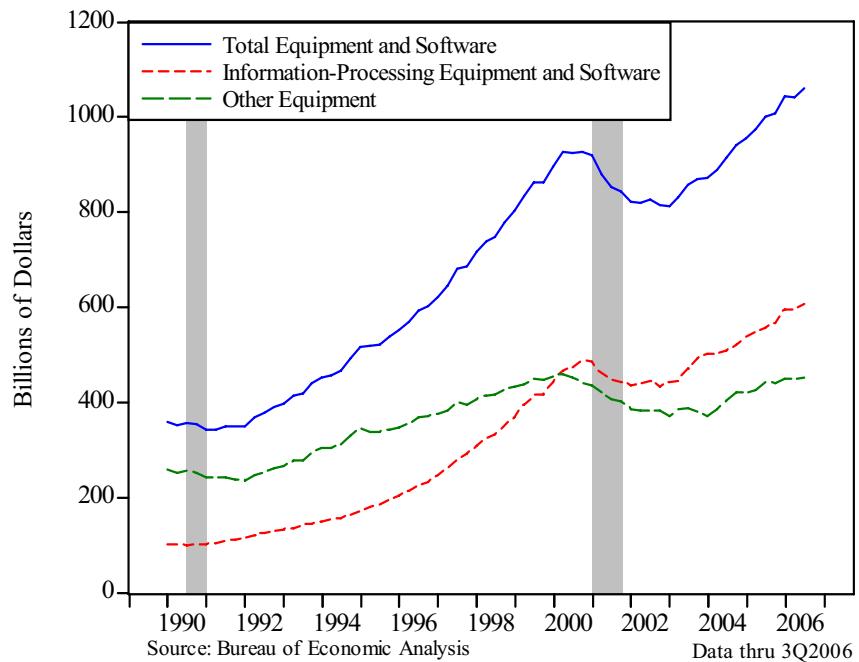
- Nearly 60 percent of total is devoted to information-processing equipment
- Remainder is spread among industrial, transportation, and other equipment

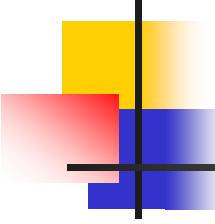
Upturn in technology spending led the upturn in general investment spending throughout this expansion

The upturn in technology spending is likely behind the big productivity gains in the current national economic recovery

While increasing, spending on general investment goods has barely reached its last cyclical peak

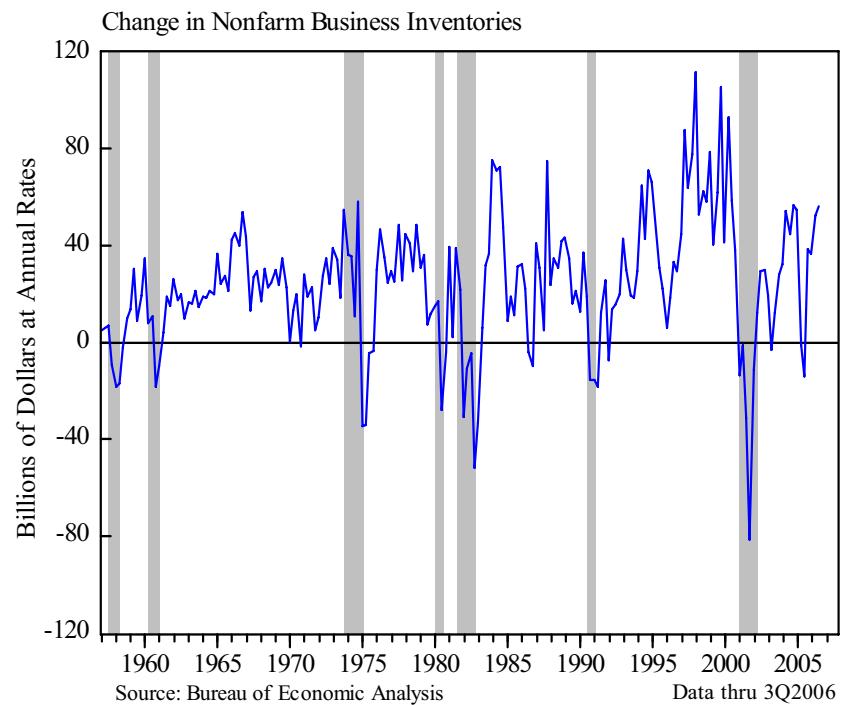
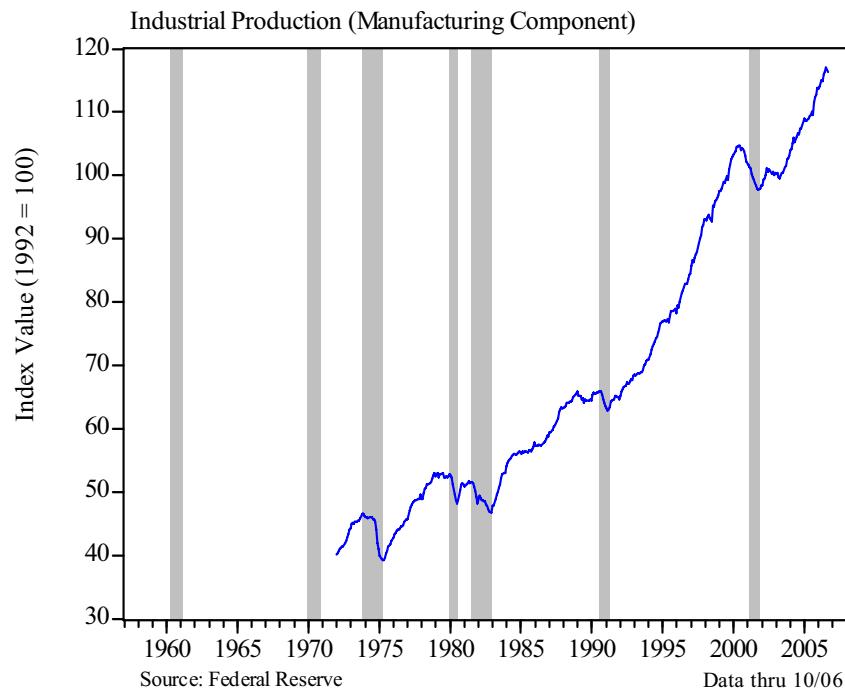
This reflects ample capacity in the manufacturing sector (roughly 81 percent in August 2006)





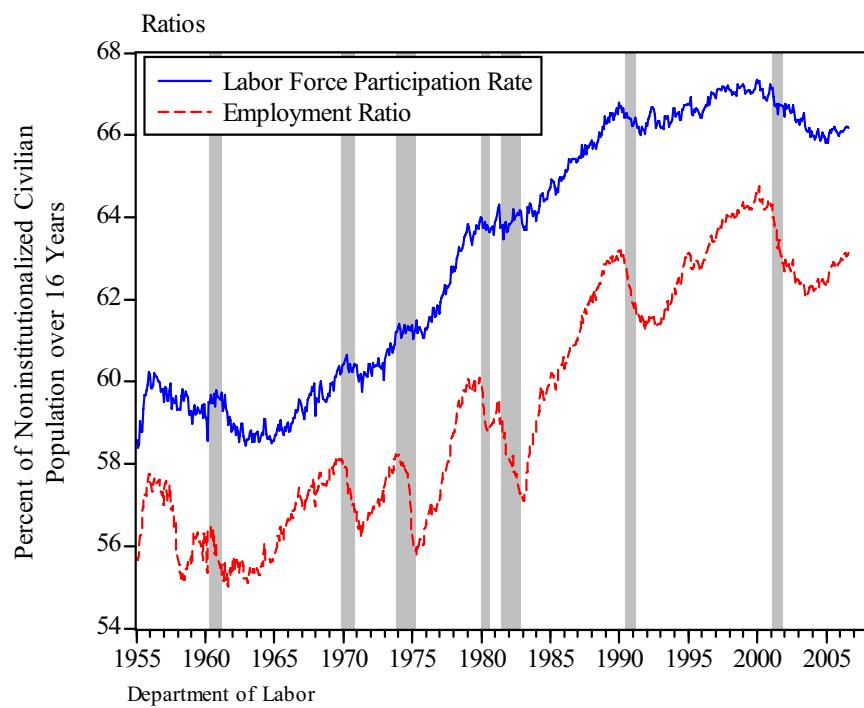
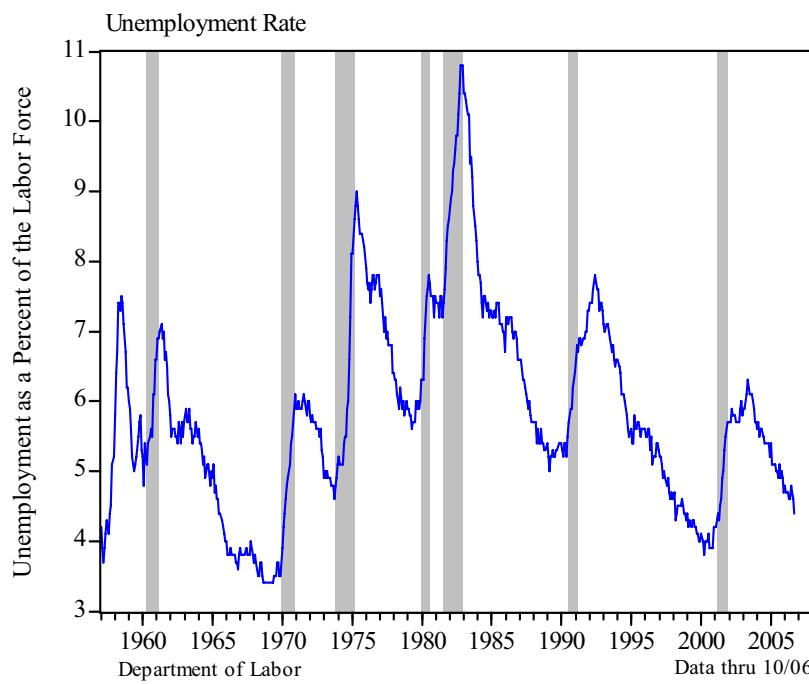
The U.S. Cycle in Perspective

Industrial Output and Changes in Inventories



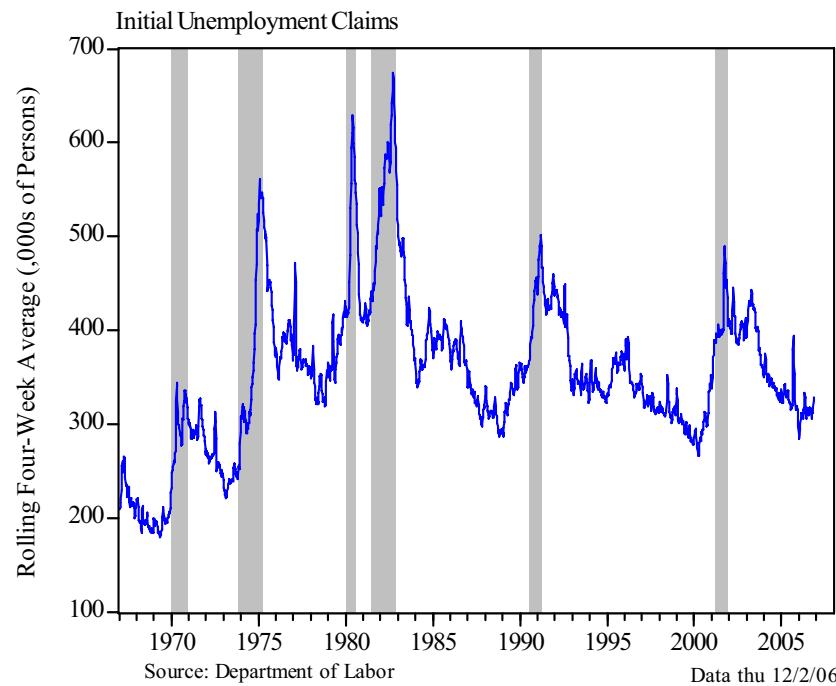
The U.S. Cycle in Perspective

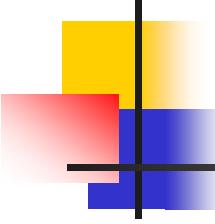
*Labor Markets: Unemployment and the Labor Force
Participation Rate and Employment Ratio*



The U.S. Cycle in Perspective

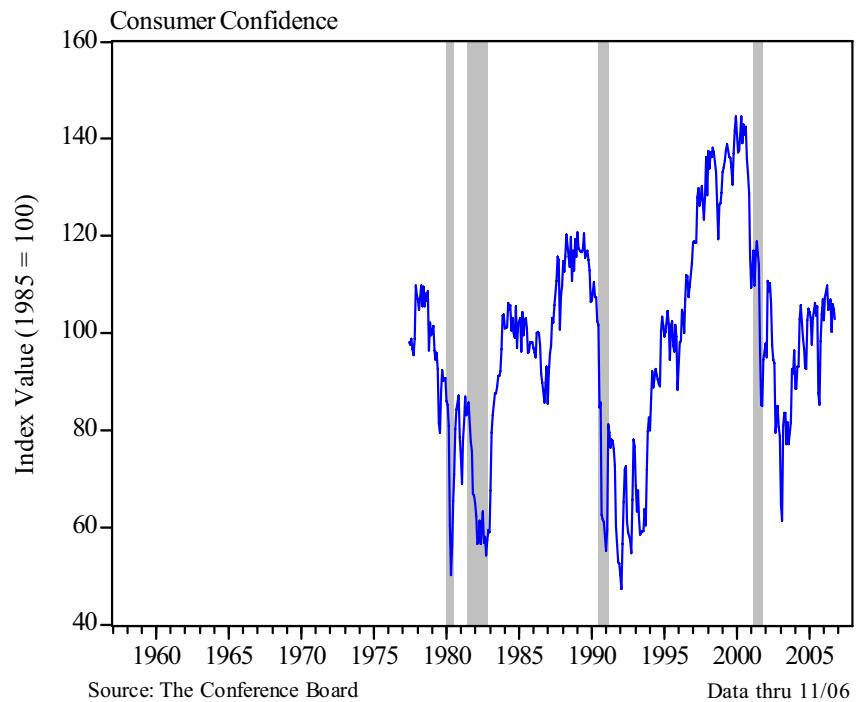
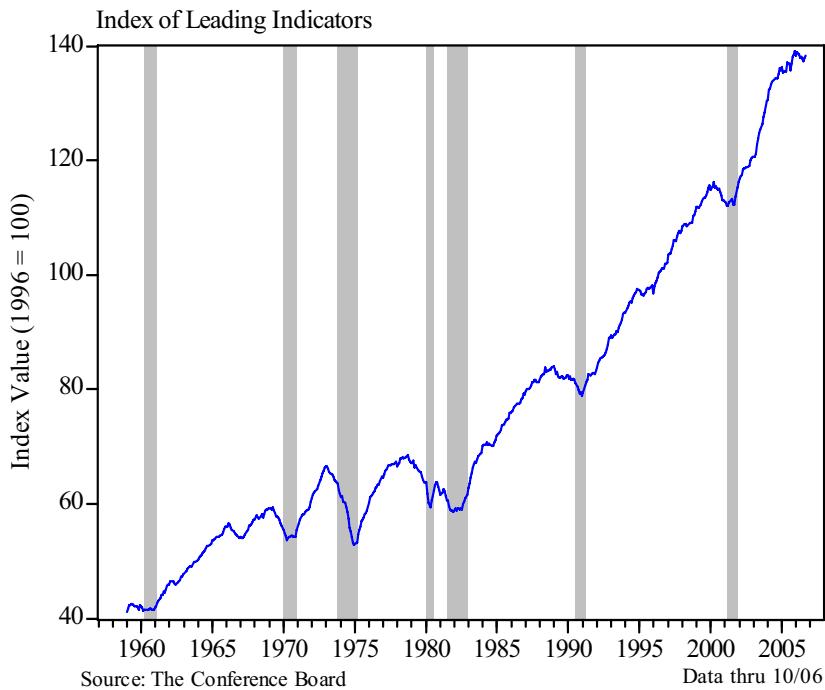
Labor Markets: Initial Unemployment Claims and the Duration of Unemployment

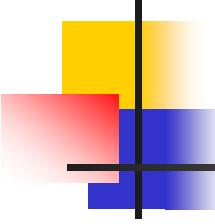




The U.S. Cycle in Perspective

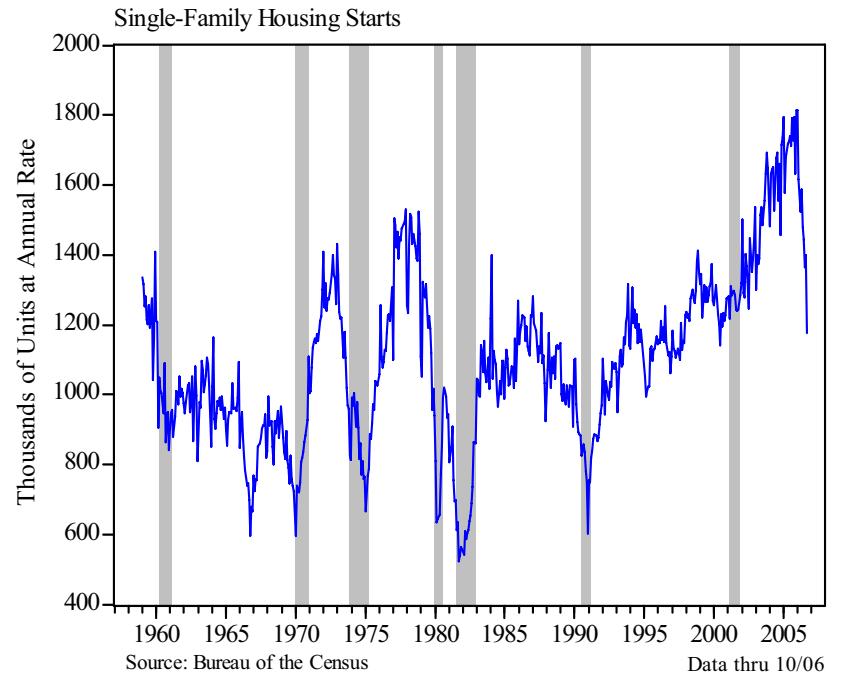
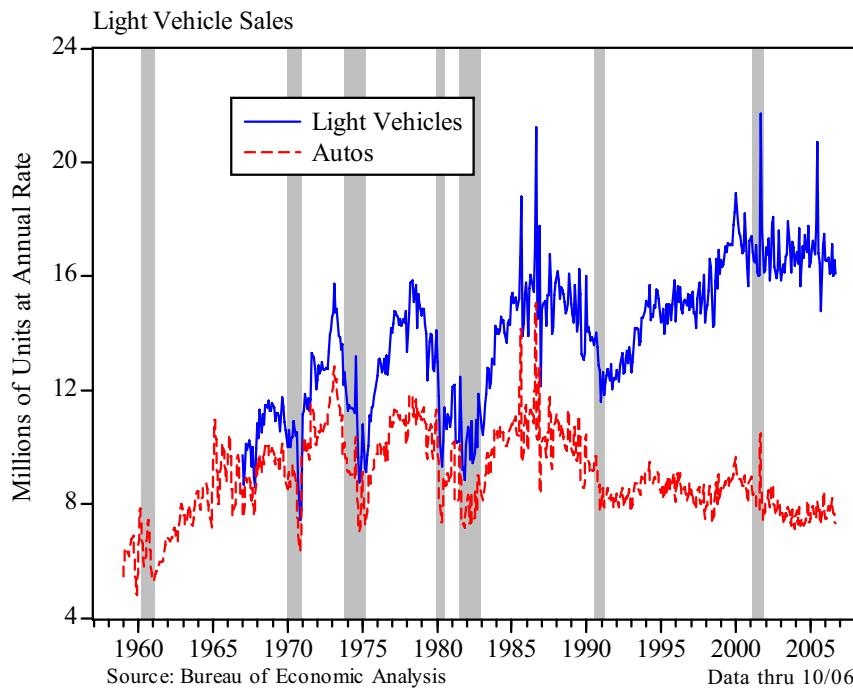
Leading Indicators and Consumer Confidence





The U.S. Cycle in Perspective

Light Vehicle Sales and Housing



The U.S. Cycle in Perspective

Equity Prices

2006 will be the fourth year to post a December-to-December gain after three years of declines

Generally, wealth effect has had minimal effect on spending in the short run

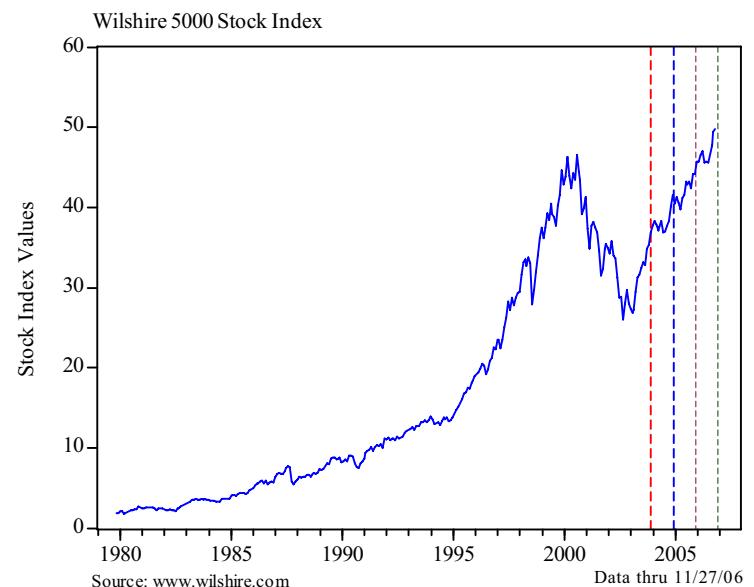
- Wealth loss in 2000-2003 did not adversely affect consumer spending
- Wealth gain in past three years did not buoy spending

However, it can affect consumer confidence/sentiment

That can have a ripple effect on spending, particularly if other factors weigh heavily

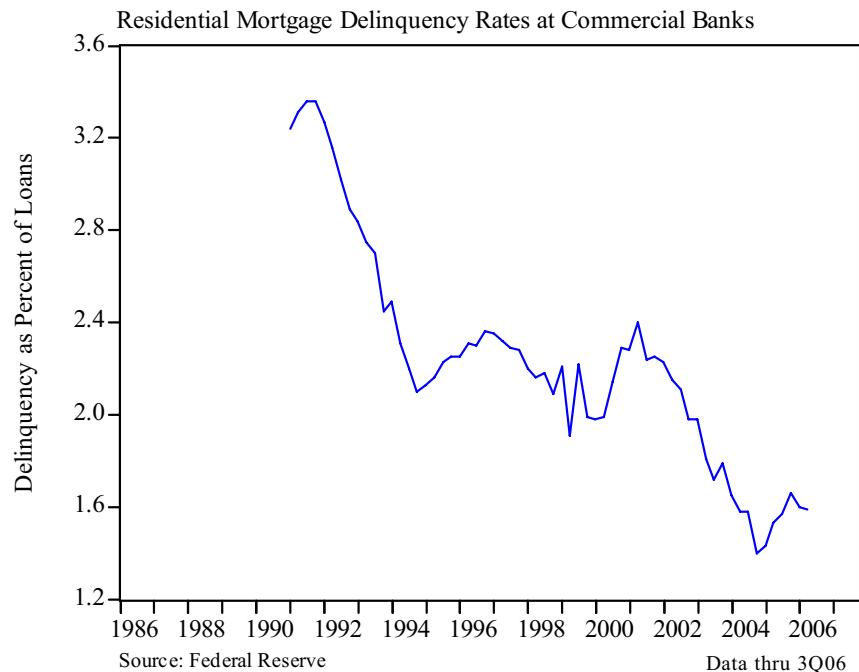
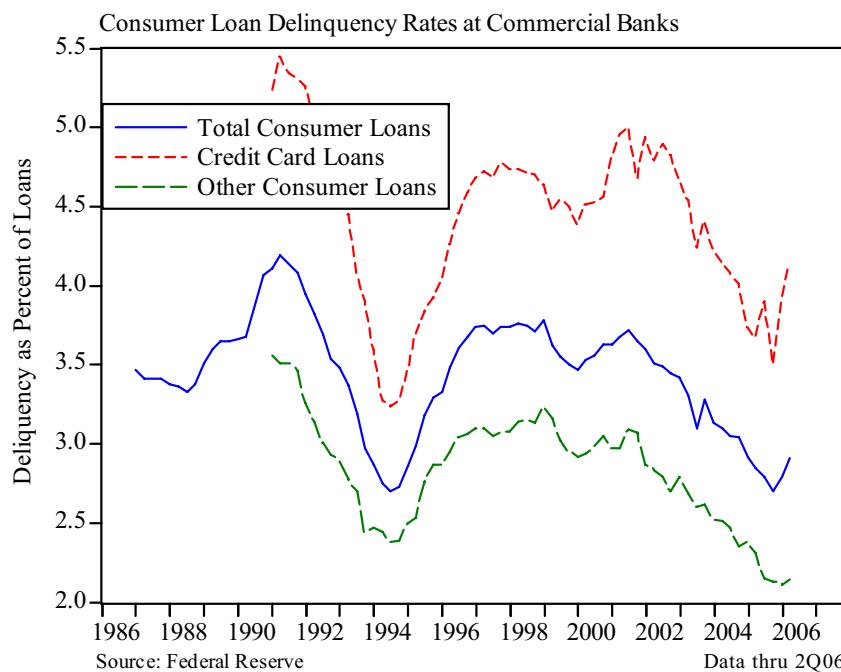
- Iraq, Iran, North Korea, and other trouble spots
- Perception of policy paralysis
- Global financial concerns

But, global reallocations by central banks will not affect equity prices unless reallocation has untoward effect on U.S. interest rates



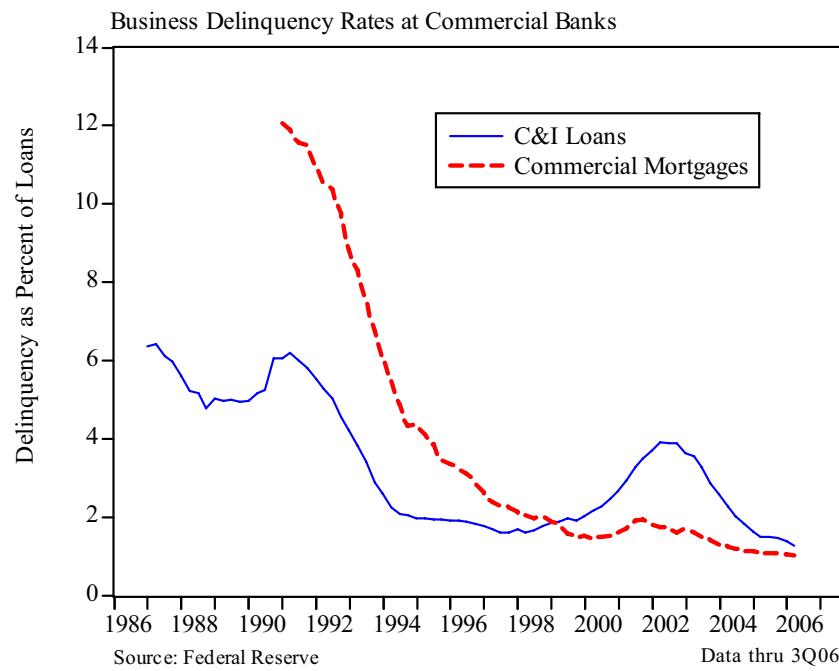
The U.S. Cycle in Perspective

Household Delinquency Rates at Commercial Banks



The U.S. Cycle in Perspective

Business Delinquency Rates at Commercial Banks



C&I loan delinquencies continue their decline

Delinquencies among commercial real estate did not turn upward during the 2000 recession

Looking forward, there is still very good news in the lending area

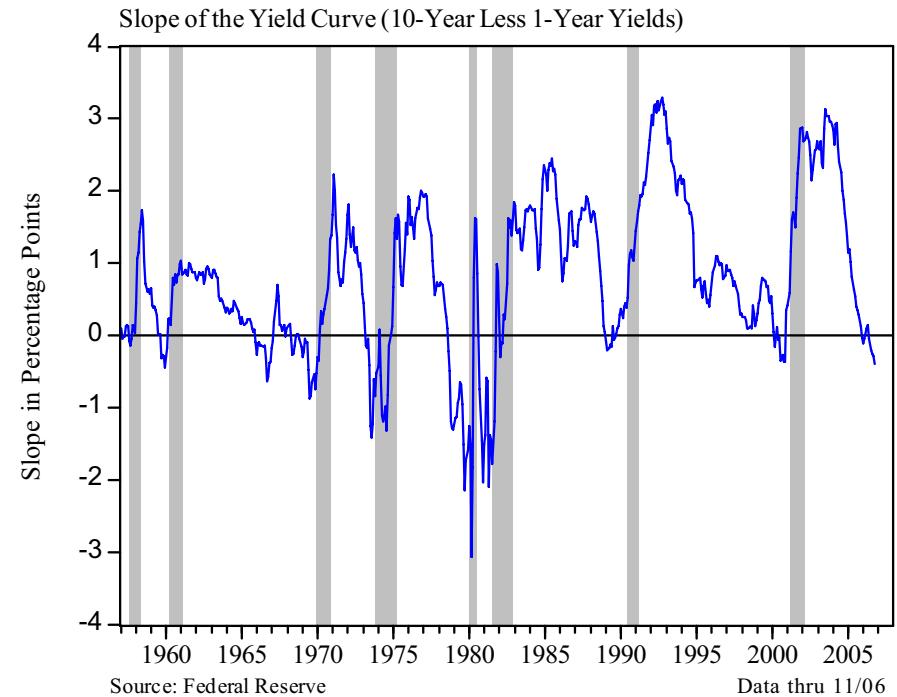
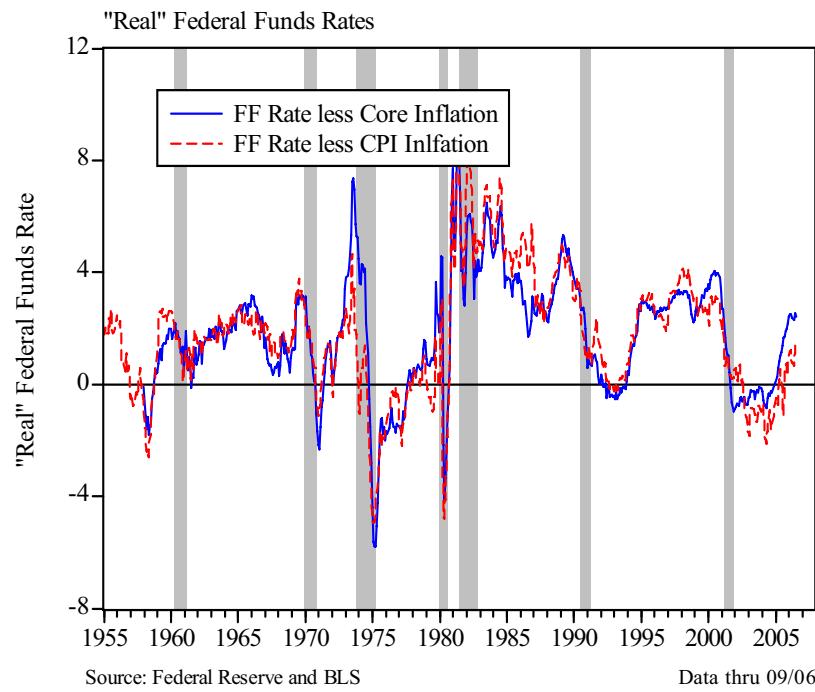
- Bank capital is excellent—a far different condition from the aftermath of the 1990 recession
- The Federal Reserve's effort to remove liquidity has not led to loan quality problems

Bottom line:

- The economy has ability to continue to finance the current business expansion
- Credit quality of bank borrowers remains very good

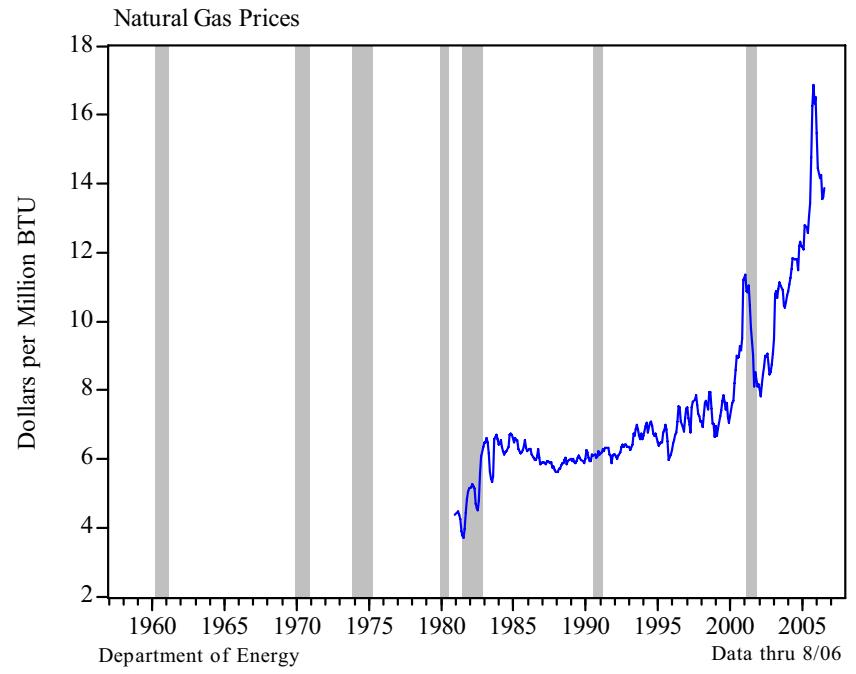
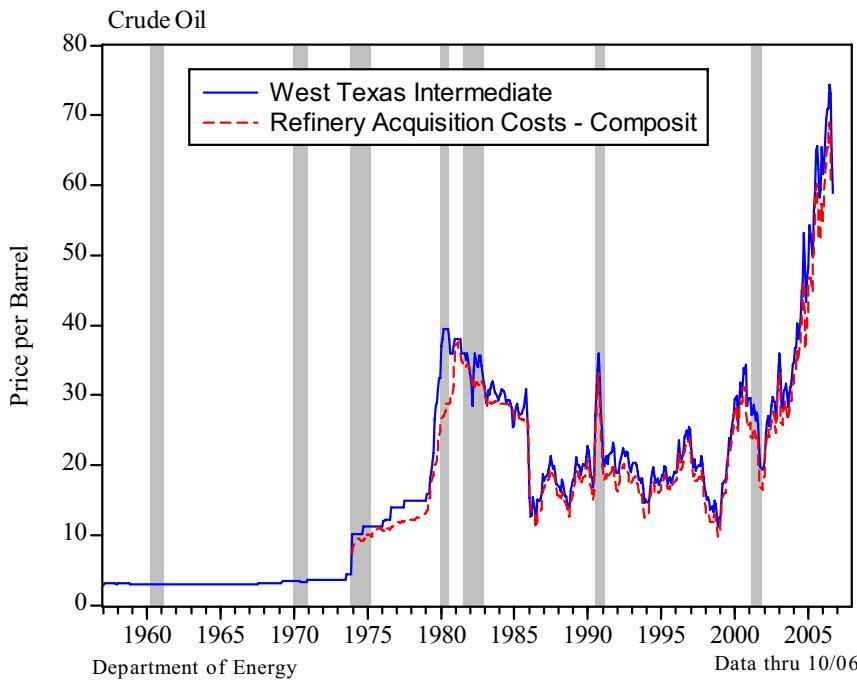
The U.S. Cycle in Perspective

Speed Bumps: The Interest Rate Regime



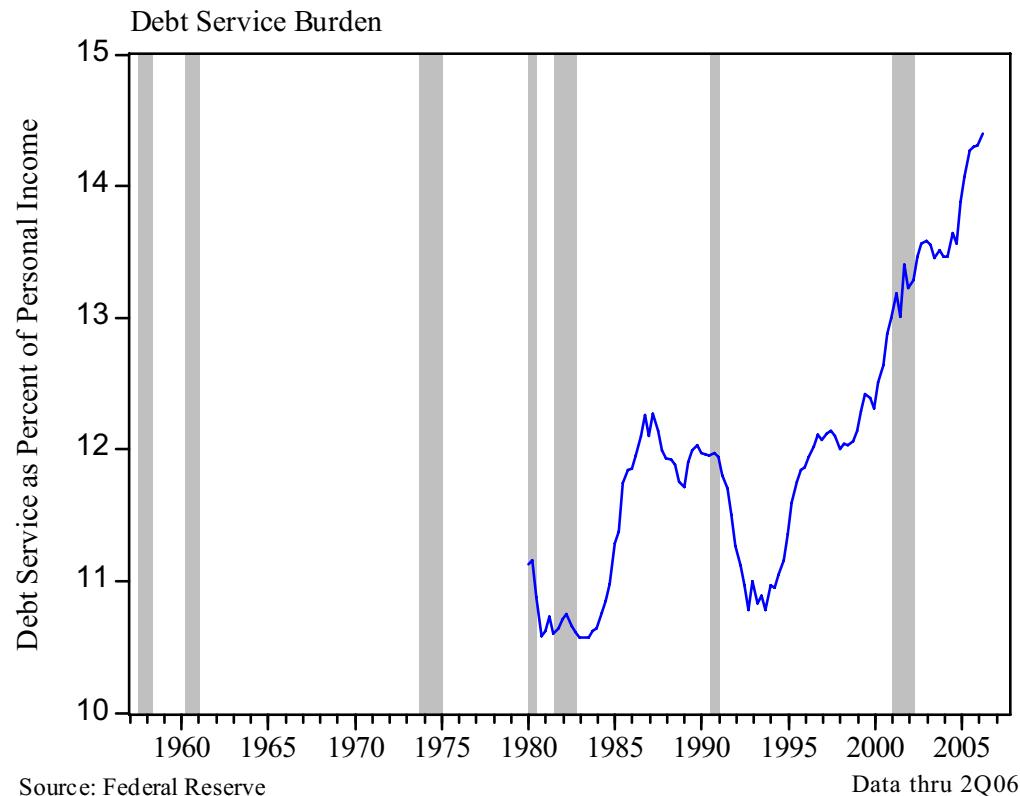
The U.S. Cycle in Perspective

Speed Bumps: Oil and Natural Gas Prices



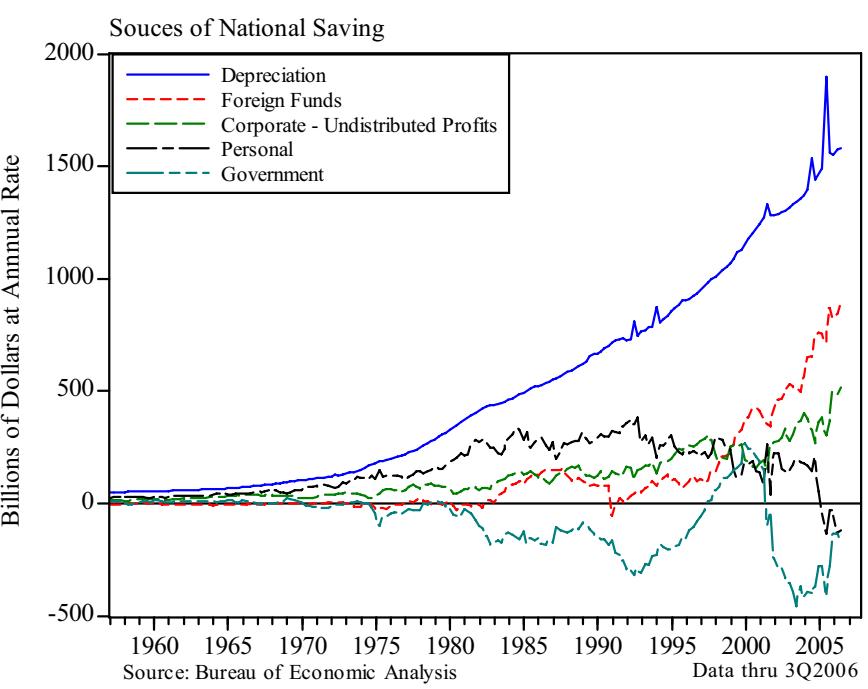
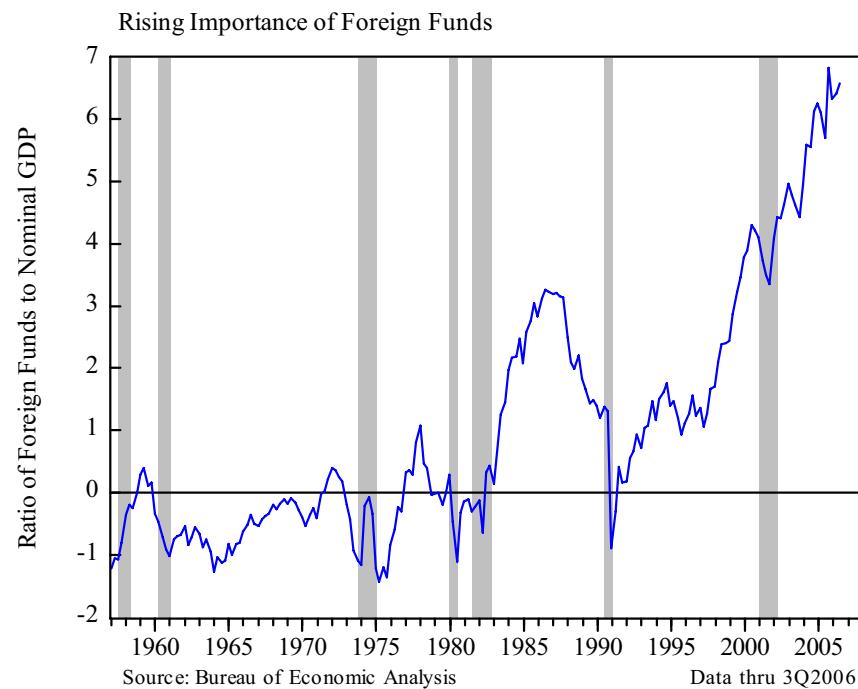
The U.S. Cycle in Perspective

Speed Bumps: Household Debt Service Burden



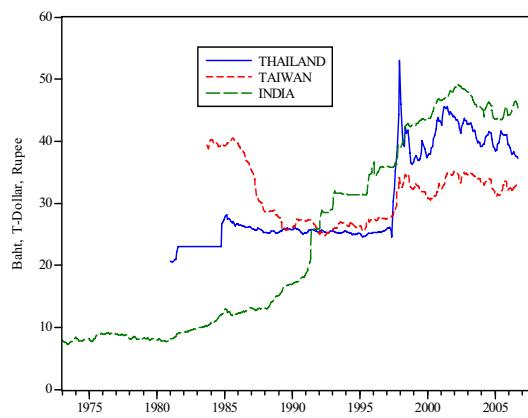
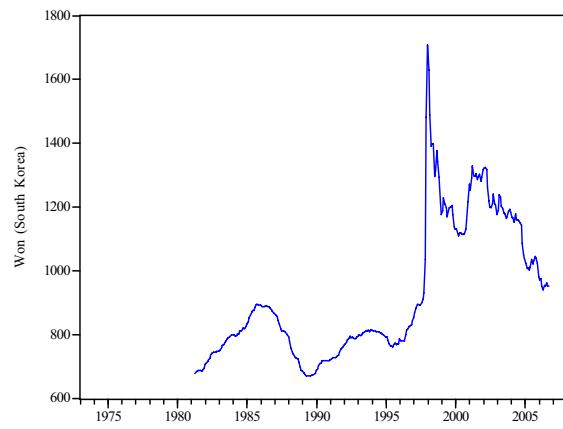
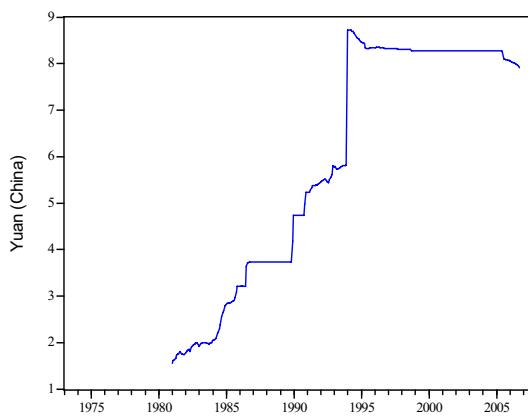
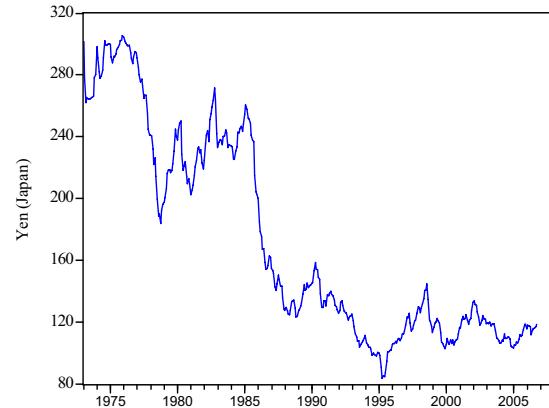
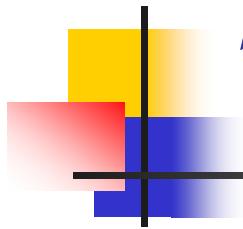
The U.S. Cycle in Perspective

Speed Bumps: U.S. Capital Inflows and National Savings



The U.S. Cycle in Perspective

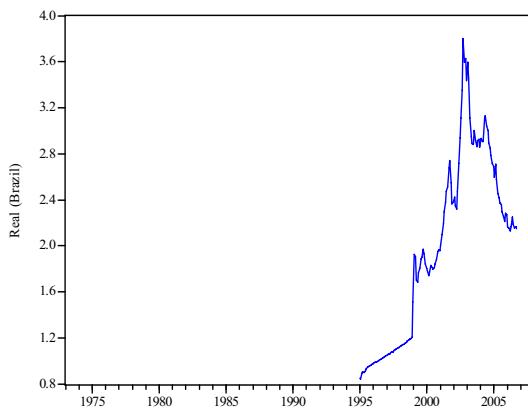
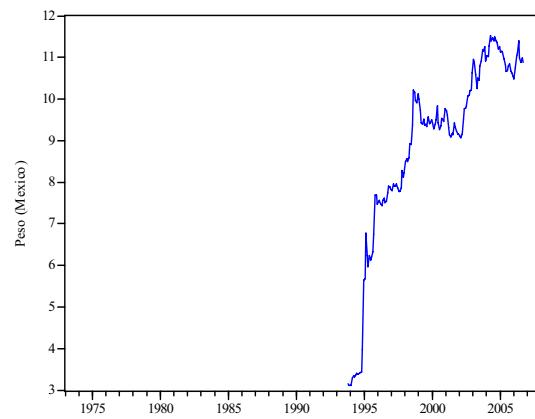
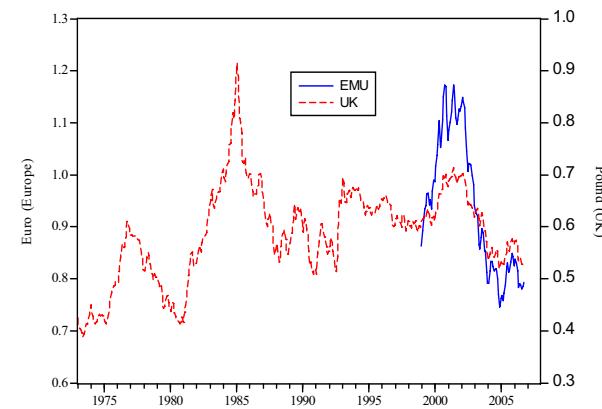
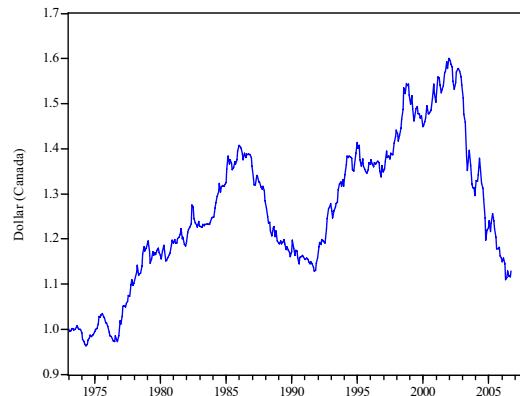
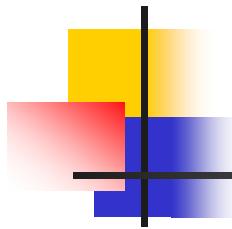
Speed Bumps: Asian Currencies



Data thru 10/06

The U.S. Cycle in Perspective

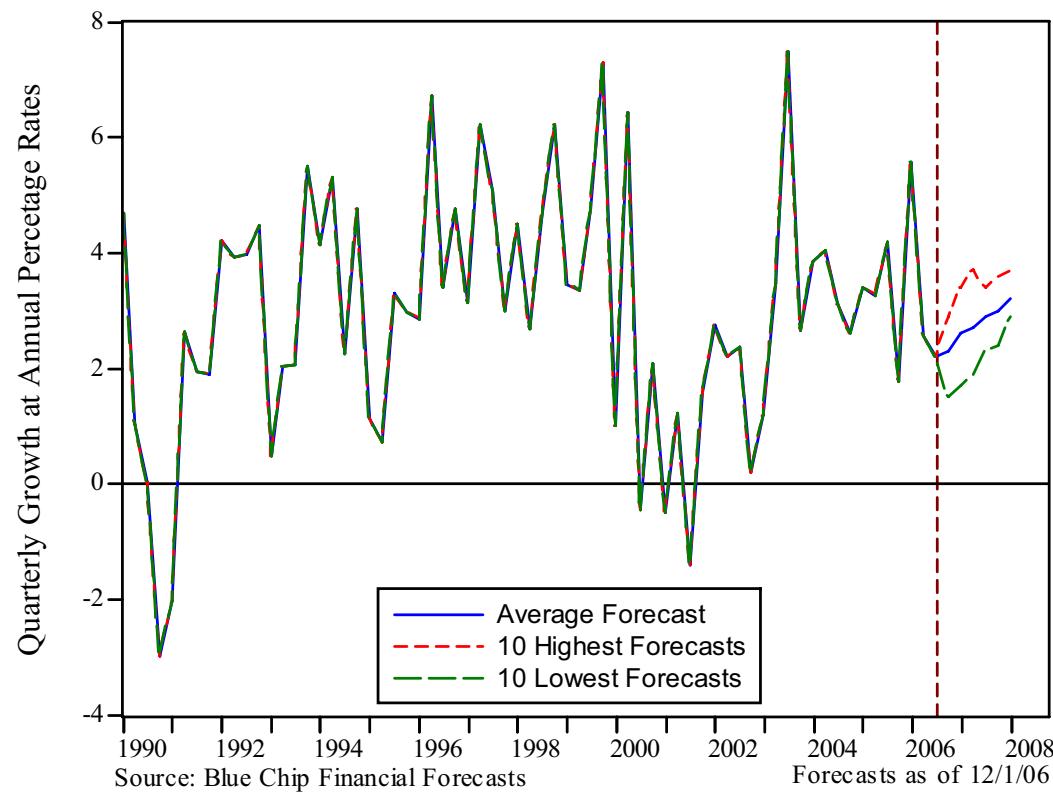
Speed Bumps: European and Western Hemisphere Currencies



Data thru 10/06

The U.S. Outlook – Graphic Portrayal

Blue Chip Short-Term Economic Forecasts



Baseline U.S. Outlook

Table 1

	2006				2007				2008				Year-over-Year Growth			
	I(A)	II(A)	III(A)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)
	2006	2006	2006	2006	2007	2007	2007	2007	2008	2008	2008	2008	2006	2007	2008	2008
1 Gross Domestic Product	13008.4	13197.3	13327.1	13434.1	13571.2	13750.1	13918.4	14108.7	14302.9	14500.2	14707.1	14924.2	6.3	4.5	5.6	5.6
2 Change *	5.3	5.3	5.3	3.2	4.1	5.4	5.0	5.6	5.6	5.6	5.8	6.0	3.3	2.4	3.3	3.3
3 Gross Dom. Product (96\$)	11316.4	11388.1	11450.5	11501.7	11555.6	11649.7	11718.5	11815.1	11913.6	12013.8	12120.5	12234.8	3.3	2.4	3.3	3.3
4 Change *	5.6	2.6	2.2	1.8	1.9	3.0	2.7	3.3	3.4	3.4	3.6	3.8	3.3	2.4	3.3	3.3
5 Personal Consum. Exp. (96\$)	8003.8	8055.0	8112.0	8169.6	8224.6	8283.9	8341.3	8403.2	8469.0	8537.0	8610.3	8688.5	3.1	2.8	3.2	3.2
6 Change *	4.8	2.6	2.9	2.9	2.7	2.9	2.8	3.0	3.2	3.2	3.4	3.5	3.7	3.1	2.8	3.2
7 Equipment and Software (96\$)	1044.8	1041.2	1059.6	1068.6	1078.8	1087.3	1095.8	1103.7	1112.9	1120.8	1128.9	1140.4	7.0	3.6	3.2	3.2
8 Change *	15.6	15.6	17.3	3.5	3.9	3.2	3.1	2.9	3.4	2.9	3.3	3.3	3.3	3.3	3.3	3.3
9 Nonresid. Construction (96\$)	259.6	271.9	282.6	286.4	285.9	286.0	283.4	282.3	285.0	288.4	292.0	296.2	9.4	3.4	2.1	2.1
10 Change *	8.8	20.3	16.7	5.4	-0.7	0.1	-3.6	-1.5	3.9	4.9	5.0	5.8	-3.9	-8.2	7.6	7.6
11 Resid. Construction (96\$)	618.5	600.5	571.4	546.1	532.7	529.6	534.5	547.5	559.2	570.9	582.7	594.8	5.8	3.4	2.1	2.1
12 Change *	-0.3	-11.1	-18.0	-16.5	-2.3	4.4	9.4	8.8	8.6	8.6	8.5	8.5	8.5	2.3	2.3	2.3
13 Federal Defense (96\$)	491.8	489.3	488.0	489.0	491.8	491.1	491.8	493.0	494.7	495.5	496.3	497.1	1.2	0.4	0.8	0.8
14 Change *	8.9	-2.0	-1.1	0.0	1.3	1.9	-0.5	0.6	1.0	1.4	0.6	0.6	0.6	0.6	0.6	0.6
15 Fed. Nondefense (96\$)	253.1	247.0	251.1	252.7	255.0	254.9	257.0	258.4	260.1	261.2	262.8	264.3	3.0	2.1	2.2	2.2
16 Change *	8.5	-9.3	6.8	3.6	-0.1	2.3	2.3	1.8	2.4	2.4	2.4	2.4	2.4	2.3	2.3	2.3
17 State + Local (96\$)	1242.0	1254.4	1262.6	1270.4	1278.1	1285.9	1294.2	1302.3	1310.5	1318.6	1326.8	1335.1	2.2	2.6	2.5	2.5
18 Change *	2.7	4.1	2.6	2.5	2.4	2.5	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.2	2.6	2.5
19 Net Exports (96\$)	-636.6	-624.2	-629.4	-623.4	-625.6	-617.5	-614.6	-611.6	-613.1	-614.7	-617.5	-620.1				
20 Chg. in Bus. Invent. (96\$)	41.2	53.7	56.0	42.4	36.3	38.7	34.9	37.4	37.0	36.9	38.0	39.3				
21 Nonfarm Inventories	36.8	52.2	56.0	42.4	36.3	38.7	34.9	37.4	37.0	36.9	38.0	39.3				
22 Farm Inventories	4.3	1.9	2.4	1.0	0.4	0.2	0.1	0.0	0.0	0.0	0.0	0.0				
23 GNP Deflator ('96=100)*	3.3	3.3	1.7	1.4	2.2	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.9	2.1	2.1	2.2
24 CPI ('82=100)*	2.2	5.0	2.9	0.3	2.4	2.7	2.6	2.5	2.5	2.5	2.5	2.5	2.3	2.5	2.5	2.5
25 GDP ('96\$)**	-0.4	4.5	0.3	-4.6	1.2	1.7	1.8	1.6	1.6	1.6	1.6	1.6	2.9	0.4	1.6	1.6
26 PPI ('982=100)*																

Cyclical Characteristics

Table 2

	2006				2007				2008				Year-over-Year Growth			
	I(A)	II(A)	III(A)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)
	2006	2006	2006	2006	2007	2007	2007	2007	2008	2008	2008	2008	2006	2007	2008	2008
1 Domestic Final Sales (96\$)	11911.8	11958.6	12021.9	12081.8	12144.6	12219.4	12298.1	12389.2	12489.7	12591.6	12700.0	12815.5	2.8	2.5	3.4	3.4
2 Change *	5.4	1.6	2.1	2.0	2.1	2.5	2.6	3.0	3.3	3.5	3.7	3.7	3.7	3.7	3.7	3.7
3 Cyclical Domestic Demand (96\$)	313.4	310.9	312.2	309.1	310.7	319.0	314.0	317.4	320.8	324.6	329.1	334.0	4.0	0.8	4.5	4.5
4 Change *	13.2	-1.2	2.2	-3.1	0.6	2.3	2.8	4.0	4.9	4.9	5.5	6.0				
5 Cyclical Consumer Demand (96\$)	1190.5	1190.3	1207.6	1195.9	1204.3	1216.1	1226.0	1237.9	1252.6	1268.5	1287.6	1308.9	4.4	2.1	4.8	4.8
6 Change *	19.8	-0.1	5.9	-3.8	2.8	3.3	3.3	3.9	4.8	5.2	6.2	6.8	6.8	3.5	2.8	2.8
7 Light Vehicles and Parts (96\$)	442.7	441.7	451.5	440.6	443.7	446.8	446.8	447.2	450.5	455.1	461.1	467.7	-0.9	0.5	2.8	2.8
8 Change *	21.6	-0.9	9.2	-9.3	2.8	2.8	0.1	0.3	3.0	4.2	5.4	5.8	5.8	3.1	5.9	5.9
9 Other Durables (96\$)	747.8	748.6	756.1	755.3	760.6	769.3	778.1	790.7	802.1	813.3	826.4	841.2	7.9	3.1	5.9	5.9
10 Change *	18.8	0.4	4.1	-0.4	2.8	4.6	5.2	6.1	5.9	5.8	6.6	7.4				
11 Fixed Investment (96\$)	1914.6	1906.8	1920.5	1901.2	1897.4	1902.9	1914.5	1933.5	1957.2	1980.1	2010.4	2031.3	3.5	0.3	4.2	4.2
12 Change *	4.8	4.8	4.8	-0.3	-0.8	1.2	1.9	2.1	4.8	5.0	5.4	5.4	5.4	-3.9	-8.2	7.6
13 Resd. Construction (96\$)	618.5	600.5	571.4	566.1	532.7	529.6	533.4	547.5	559.2	570.9	582.7	594.8	5.4	3.1	3.1	3.1
14 Change *	-0.3	-11.1	-18.0	-16.5	-9.5	-2.3	4.4	9.4	8.8	8.6	8.6	8.5	8.5	3.1	3.1	3.1
15 Nonresid. Construction (96\$)	256.9	271.9	282.6	286.4	285.9	286.0	283.4	282.3	285.0	288.4	292.2	296.2	9.4	3.4	2.1	2.1
16 Change *	8.8	20.3	16.7	5.4	-0.7	0.1	-3.6	-1.5	3.9	4.9	5.0	5.8	5.8	3.4	2.1	2.1
17 Equipment and Software (96\$)	1044.8	1041.2	1059.6	1087.8	1087.3	1095.8	1103.7	1112.9	1120.8	1128.9	1140.4	1140.4	7.0	3.6	3.2	3.2
18 Change *	15.6	7.3	3.9	3.5	2.9	3.4	3.4	3.4	3.3	3.4	3.4	3.4	3.4	2.9	2.9	2.9
19 Noncyclical Demand (96\$)@	82,03.0	82,84.2	83,29.3	84,04.6	84,54.0	85,21.7	85,78.0	86,43.7	87,03.9	87,65.2	88,28.4	88,94.6	3.1	2.9	2.9	2.9
20 Change *	2.9	2.2	3.7	2.4	3.2	3.1	2.8	2.8	2.8	2.9	3.0	3.0	3.0	3.0	3.0	3.0
21 Chg. in Business Inventories	41.2	53.7	58.0	43.3	36.7	39.8	35.0	37.4	37.0	36.9	38.0	39.3				
22 Gross Domestic Purchases (96\$) & Change *	11955.0	12013.5	12085.7	12125.1	12181.2	12258.2	12331.1	12426.7	12526.3	12628.5	12738.0	12854.9	3.3	2.1	3.1	3.1
23 Change *	5.4	2.0	2.4	1.3	1.9	2.6	2.5	3.1	3.3	3.3	3.5	3.7				
24 Net Exports (96\$)	-636.6	-624.2	-629.4	-623.4	-625.6	-617.5	-614.6	-611.6	-613.1	-614.7	-617.5	-620.1				
25 GDP ('96\$)**	1136.4	11388.1	11450.5	11501.7	11555.6	11640.7	11718.5	11815.1	11913.6	12013.8	12120.5	12234.8	3.3	2.4	3.3	3.3
26 Change *	5.6	2.6	2.2	1.8	1.9	3.0	2.7	3.3	3.4	3.4	3.6	3.8				

@ Noncyclical Demand = Consumer spending on nondurable goods and services and all forms of government spending (excluding CCC inventories)

* Quarter-to-quarter percent Change *

& Gross Domestic Purchases = Domestic final demand plus Change *

** Actual; E = Forecast

Except for price indexes, all data in billions of dollars

Historical sources: BEA and BLS

December 8, 2006

Household Sector

	2006				2007				2008				Year-over-Year Growth			
	I(A)	II(A)	III(A)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)
1 Personal Income (\$ Bl.)	10721.4	10807.3	10954.0	11052.3	11161.7	11278.9	11409.4	11549.6	11704.3	11862.9	12029.1	12202.0	6.3	4.3	5.3	
2 Change *	9.4	3.2	5.5	3.6	4.0	4.3	4.7	5.0	5.5	5.5	5.7	5.9				
3 Civilian Employment (Mln.)	143.3	144.0	144.6	145.0	145.4	145.9	146.2	146.6	147.0	147.5	148.0	148.5	1.8	1.3	1.2	
4 Change *	1.8	1.9	1.6	1.2	1.2	1.1	1.0	1.0	1.2	1.2	1.3	1.4				
5 Unemployment Rate	4.7	4.6	4.7	4.6	4.7	4.6	4.7	4.9	4.8	4.9	5.1	5.2	5.4			
6 Personal Consump. Exp. ('96\$)	8003.8	8055.0	8112.0	8169.6	8224.6	8283.9	8341.3	8403.2	8469.0	8537.0	8610.3	8688.5	3.1	2.8	3.2	
7 Change *	4.8	2.9	2.9	2.9	2.7	2.9	2.8	3.0	3.2	3.2	3.5	3.7				
8 Autos & Parts	442.7	441.7	451.5	440.6	443.7	446.8	446.9	447.2	450.5	455.1	461.1	467.7	-0.9	0.5	2.8	
9 Change *	21.6	-0.9	9.2	-9.3	2.8	2.8	0.1	0.3	3.0	4.2	5.4	5.8				
10 Other Durable Goods	748.6	756.1	755.3	760.6	769.3	779.1	780.7	802.1	813.3	826.4	841.2	7.9	3.1	5.9		
11 Change *	18.8	0.4	4.1	-0.4	2.8	4.6	5.2	5.9	5.8	6.6	7.4					
12 Nondurable Goods	2342.8	2351.1	2357.7	2369.4	2383.0	2397.5	2412.2	2428.8	2445.9	2463.5	2482.7	2503.4	3.4	2.1	2.8	
13 Change *	5.9	1.1	2.3	2.3	2.5	2.8	2.9	3.1	3.4	3.4	3.7	3.9				
14 Services	4949.5	4535.4	4570.7	4604.3	4637.4	4670.3	4736.5	4770.5	4805.0	4840.1	4876.2	5.6	3.0	2.9		
15 Change *	1.6	3.7	3.1	3.0	2.9	2.9	2.8	2.9	2.9	3.0	3.0					
16 Lt. Vehicles	16.9	16.3	16.6	16.2	16.1	16.0	15.9	16.0	16.0	16.2	16.3	-2.8				
17 Change *	24.6	-13.0	7.4	-9.9	-1.9	1.3	-2.2	-2.5	0.9	1.7	2.9	3.4				
18 New Auto Sales (Mln.)	7.8	7.8	8.4	8.4	8.3	8.1	7.9	7.9	7.8	7.8	7.8	4.0	3.9	-5.2		
19 Change *	14.4	0.7	1.8	30.7	-1.9	1.3	-5.9	-6.2	-10.4	-2.4	-1.3	-0.8				
20 New Light Truck Sales (Mln.)	7.5	7.5	7.8	7.7	7.7	7.8	7.8	8.1	8.2	8.3	8.5	45.3	2.1	6.4		
21 Change *	9.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0					
22 Private Housing Starts (Mln.)	2,123	1,873	1,720	1,462	1,505	1,506	1,565	1,686	1,706	1,752	1,813	1,875	-13.5	-13.2	14.7	
23 Change *	12.9	-39.5	-28.9	-47.8	12.5	0.3	16.5	25.5	12.5	11.3	14.7	14.4				
24 Single-Family	1,747	1,550	1,403	1,200	1,250	1,300	1,375	1,413	1,450	1,500	1,550	1.5%				
25 Multi-Family	0.376	0.343	0.316	0.262	0.255	0.265	0.281	0.293	0.302	0.313	0.325	0.325				
26 Existing Home Sales ('Th.)	6790.0	6686.7	6280.0	5711.3	5412.4	5248.1	5284.3	5422.5	5607.1	5780.4	5964.0	6149.5	-9.9	-16.2	10.1	
27 Change *	8.7	-2.5	-0.5	2.9	1.5	2.4	1.6	2.1	1.8	2.0	1.8	1.5				

Corporate Sector

	2006				2007				2008				Year-over-Year Growth			
	I(A)	II(A)	III(A)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)
1 Fixed Business Invest. ('96\$)	1288.3	1302.8	1334.1	1355.0	1364.7	1373.3	1379.1	1386.0	1398.0	1409.3	1421.9	1436.6	7.9	4.2	3.0	
2 Change *	5.3	5.4	5.4	6.4	2.6	2.6	3.5	3.5	3.3	3.2	4.2	4.2				
3 Structures	259.6	271.9	282.6	288.4	285.9	286.0	283.4	282.3	285.0	288.4	292.0	296.2	9.4	3.4	2.1	
4 Change *	8.8	20.3	16.7	5.4	-0.7	0.1	-1.5	3.9	4.9	5.0	5.8					
5 Producer Equip. & Software	1044.8	1041.2	1059.6	1068.6	1078.8	1087.3	1095.8	1103.7	1112.9	1120.8	1129.9	1140.4	7.0	3.6	3.2	
6 Change *	15.6	-14	7.3	3.5	3.9	3.2	3.1	2.9	3.4	2.9	3.3	3.8				
7 Chg. in Bus. Invent. ('96\$)	41.2	53.7	58.0	43.3	36.7	38.8	35.0	37.4	37.0	36.9	38.0	39.3				
8 Chg. in Nonfarm Inventories	36.8	52.2	56.0	42.4	36.3	38.7	34.9	37.4	37.0	36.9	38.0	39.3				
9 Corporate Profits (B.T.)	1740.6	1811.5	1857.8	1855.1	1856.6	1856.1	1864.7	1895.8	1924.1	1942.1	1960.3	1966.6	15.3%	15.7	10.2	
10 Corporate Profits (A.T.)	1283.7	1335.4	1366.6	1356.1	1364.7	1367.1	1395.8	1424.1	1460.3	1486.6	1533.5	1573.2	1618.4	19.3	5.7	
11 Change *	43.1	17.1	9.7	-3.0	2.6	9.4	8.4	10.6	10.3	10.2	10.8	12.0				
12 Internal Funds (A.T.)	915.3	933.0	930.7	939.0	950.3	964.9	980.7	996.4	1011.9	1027.9	1042.5	1058.2	10.1	4.7	6.4	
13 Change *	42.0	-10	3.6	4.9	6.1	6.8	6.6	6.4	6.4	6.3	6.0	6.1				
14 Dividends	615.7	631.1	650.4	664.7	677.1	690.6	705.1	720.7	737.0	754.1	771.8	790.5	11.0	9.0	9.3	
15 Change *	10.1	10.4	12.8	9.1	7.7	8.2	8.6	9.2	9.4	9.6	9.7	10.0				
16 Output per Hour*	4.5	1.1	0.4	0.7	0.8	2.0	1.8	2.6	2.5	2.4	2.5	2.7	2.1	1.2	2.4	
17 Hourly Compensation *	4.2	4.2	4.2	0.2	3.7	3.5	4.2	4.2	4.5	4.2	4.5	4.7	5.0	2.7	4.3	
18 Unit Labor Costs *	8.7	-2.5	-0.5	2.9	1.5	2.4	1.6	2.1	1.8	2.0	1.8	1.5				
19 Trade-Weighted Index	84.9	82.2	81.7	79.3	79.3	79.7	80.1	80.6	81.2	81.7	82.1	85.6	-2.1	-2.6	3.4	

International Sector

	2006				2007				2008				Year-over-Year Growth			
	I(A)	II(A)	III(A)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)
1 Net Exports ('96\$)	-636.6	-624.2	-629.4	-623.4	-625.6	-617.5	-614.6	-611.6	-613.1	-614.7	-617.5	-620.1				
2 Exports ('96\$)	1269.3	1288.5	1308.3	1325.1	1343.4	1371.7	1397.8	1423.4	1449.0	1472.8	1498.9	1525.8	8.5	6.6	7.4	
3 Change *	14.0	6.2	5.2	5.6	8.5	9.2	9.3	7.4	6.7	7.3	7.4					
4 Imports ('96\$)	1905.9	1912.7	1937.7	1948.5	1968.0	1988.6	2011.7	2025.0	2082.1	2087.5	2116.4	2145.8	6.1	3.9	5.1	
5 Change *	9.1	1.4	5.3	2.3	4.3	4.0	4.7	4.7	5.4	5.0	5.7	5.7				
6 Trade-Weighted Index	84.9	82.2	81.7	79.3	79.3	79.7	80.1	80.6	81.2	81.7	82.1	85.6	-2.1	-2.6	3.4	

Except where noted, all data in billions of dollars.

*Quarter-to-quarter percent changes expressed at compound annual rates.

A = Actual; E = Forecast

Table 4

Historical sources: BEA, BLS, and Federal Reserve

Table 3

December 8, 2006

Outlook for Interest Rates

Market-Based Forecasts: Futures Market over the Next Year

Futures market sees a federal funds rate cut sometime in the first quarter of 2007

- Accuracy of such forecasts is marginal at best

Nonetheless, this view is reflected in long-term Treasury yields

- Current yields are low for this phase of the interest rate cycle
- This suggests bond market is also poised for lower rates

Hedge funds have also been positioned for lower rates

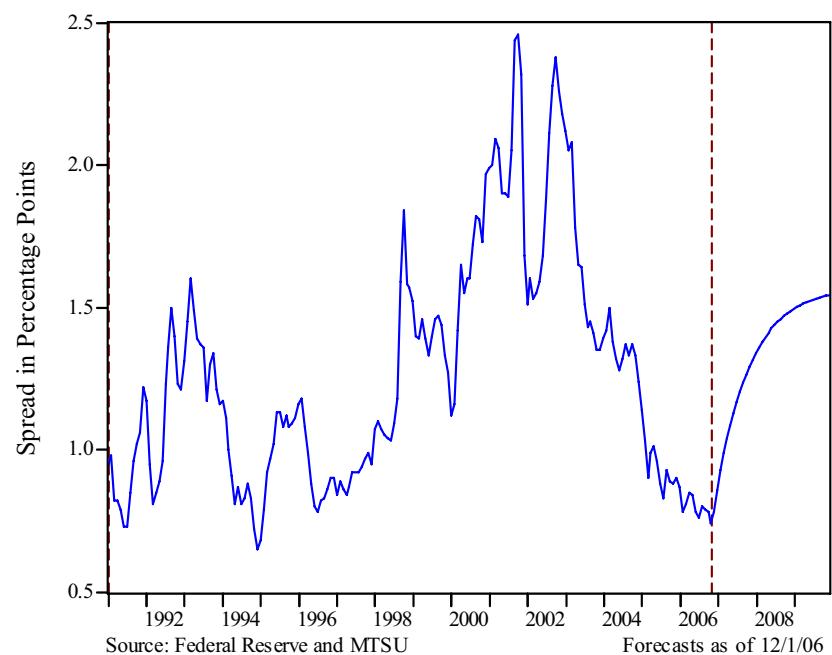
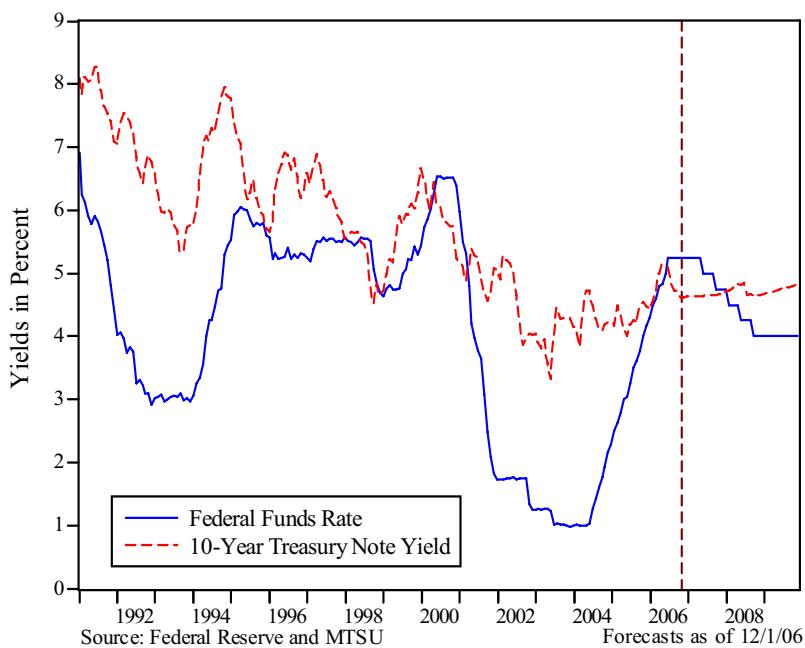
- Since August, the net long positions in 10-year note for non-commercial (speculative use) has been at historic highs

Federal Funds Futures Contracts		
Contract	Settlement	Implicit Rate
Dec-06	94.765	5.235
Jan-07	94.765	5.235
Feb-07	94.785	5.215
Mar-07	94.805	5.195
Apr-07	94.870	5.130
May-07	94.960	5.040
Jun-07	95.005	4.995
Jul-07	95.130	4.870
Aug-07	95.235	4.765
Sep-07	95.285	4.715
Oct-07	95.345	4.655
Nov-07	95.425	4.575
Dec-07	95.475	4.525
Jan-08	95.470	4.530
Feb-08	95.480	4.520

Source: CBOT as of 12/7/06

Interest Rate Outlook – Graphic Portrayal

MTSU Baseline Interest Rate Forecast



Money Market Interest Rates

Table 6

	2006				2007				2008				Annual Averages		
	I(A) 2006	II(A) 2006	III(A) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	I(E) 2008	II(E) 2008	III(E) 2008	IV(E) 2008	2004	2005	2006
1 Federal Funds	4.46	4.87	5.25	5.25	5.25	5.17	5.00	4.75	4.58	4.42	4.25	4.00	4.96	5.04	4.31
Commercial Paper															
2 1-Month	4.48	4.95	5.22	5.25	5.25	5.24	5.10	4.88	4.70	4.57	4.43	4.20	4.98	5.12	4.48
3 3-Month	4.51	4.96	5.22	5.21	5.31	5.25	5.11	4.89	4.75	4.61	4.46	4.24	4.97	5.14	4.51
4 6-Month	4.58	5.05	5.24	5.24	5.32	5.30	5.15	4.93	4.78	4.64	4.50	4.27	5.03	5.17	4.55
Finance Paper															
5 1-Month	4.51	4.98	5.26	5.27	5.23	5.22	5.08	4.85	4.66	4.54	4.40	4.17	5.01	5.10	4.44
6 3-Month	4.58	5.04	5.29	5.26	5.33	5.27	5.13	4.91	4.77	4.63	4.48	4.25	5.04	5.16	4.53
7 6-Month	4.63	5.07	5.30	5.28	5.35	5.29	5.15	4.91	4.77	4.61	4.47	4.23	5.07	5.17	4.52
Treasury Bills															
8 1-Month	4.50	4.83	5.03	5.09	5.16	5.08	4.91	4.68	4.53	4.37	4.21	3.96	4.86	4.96	4.27
9 3-Month	4.65	5.03	5.17	5.16	5.21	5.13	4.97	4.77	4.66	4.54	4.42	4.22	5.00	5.02	4.46
Negotiable CDs															
10 1-Month	4.57	5.04	5.31	5.34	5.32	5.32	5.18	4.93	4.72	4.61	4.47	4.22	5.07	5.19	4.51
11 3-Month	4.72	5.17	5.39	5.36	5.45	5.42	5.26	5.01	4.83	4.71	4.55	4.30	5.16	5.29	4.60
12 6-Month	4.86	5.29	5.45	5.35	5.43	5.38	5.20	5.00	4.90	4.78	4.66	4.47	5.24	5.26	4.70
Eurodollar Deposit															
13 1-Month	4.60	5.07	5.34	5.36	5.32	5.32	5.18	4.93	4.71	4.60	4.45	4.20	5.09	5.19	4.49
14 3-Month	4.75	5.20	5.43	5.40	5.48	5.44	5.28	5.04	4.85	4.72	4.56	4.31	5.19	5.31	4.61
15 6-Month	4.89	5.31	5.47	5.39	5.47	5.42	5.23	5.02	4.93	4.81	4.67	4.49	5.27	5.28	4.73

Capital Market Instruments

Table 7

	2006				2007				2008				Annual Averages		
	I(A) 2006	II(A) 2006	III(A) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	I(E) 2008	II(E) 2008	III(E) 2008	IV(E) 2008	2006	2007	2008
U.S. Treasury Notes and Bonds															
1 1-Yr Note	4.63	5.02	5.09	5.05	5.12	5.06	5.00	4.78	4.70	4.58	4.48	4.22	4.95	4.99	4.50
2 2-Yr Note	4.60	4.99	4.93	4.79	4.82	4.83	4.83	4.83	4.74	4.65	4.55	4.39	4.83	4.83	4.58
3 5-Yr Note	4.55	5.00	4.84	4.64	4.61	4.62	4.62	4.64	4.73	4.84	4.79	4.76	4.62	4.75	4.75
4 10-Yr Note	4.57	5.08	4.90	4.66	4.63	4.64	4.65	4.67	4.74	4.82	4.73	4.64	4.80	4.65	4.73
5 30-Yr Note	4.76	5.29	5.09	4.88	4.99	4.93	4.90	4.97	4.97	5.01	5.03	5.01	4.95	5.00	
Other Bonds															
6 AAA Bonds	5.39	5.90	5.68	5.43	5.56	5.72	5.85	5.96	6.10	6.23	6.18	6.12	5.80	5.77	6.16
7 BAA Bonds	6.31	6.74	6.59	6.30	6.47	6.74	6.90	6.98	7.07	7.16	7.07	6.99	6.48	6.77	7.08
8 State and Local	4.41	4.60	4.42	4.24	4.41	4.61	4.73	4.80	4.89	4.97	4.92	4.87	4.42	4.64	4.91
Mortgage Rates - Primary Mkt															
9 30-Yr (FHLMC - PMMS)	6.06	6.48	6.33	6.10	6.12	6.17	6.22	6.26	6.35	6.45	6.38	6.30	6.24	6.19	6.37
10 15-Yr (FHLMC - PMMS)	5.64	6.04	5.93	5.73	5.79	5.86	5.93	5.93	6.04	6.17	6.13	6.01	5.83	5.87	6.09
11 ARM (FHLMC - PMMS)	5.31	5.65	5.66	5.59	5.85	6.04	6.21	6.17	6.24	6.23	6.22	6.02	5.85	6.07	6.18
Mortgage Rates - Secondary Mkt															
12 30-Yr (FHLMC Req Net Yield)	6.24	6.59	6.56	6.32	6.33	6.36	6.40	6.43	6.51	6.60	6.52	6.44	6.43	6.38	6.52
13 15-Yr (FHLMC Req Net Yield)	5.85	6.23	6.22	6.01	5.98	5.96	5.95	5.94	6.02	6.11	6.05	5.90	6.08	5.96	6.02

Sources: Federal Reserve, Federal Home Loan Bank, Federal Home Loan Mortgage Corp

A = Actual; E = Forecast

The Tennessee Cycle in Perspective

Personal Income – Tennessee versus U.S.

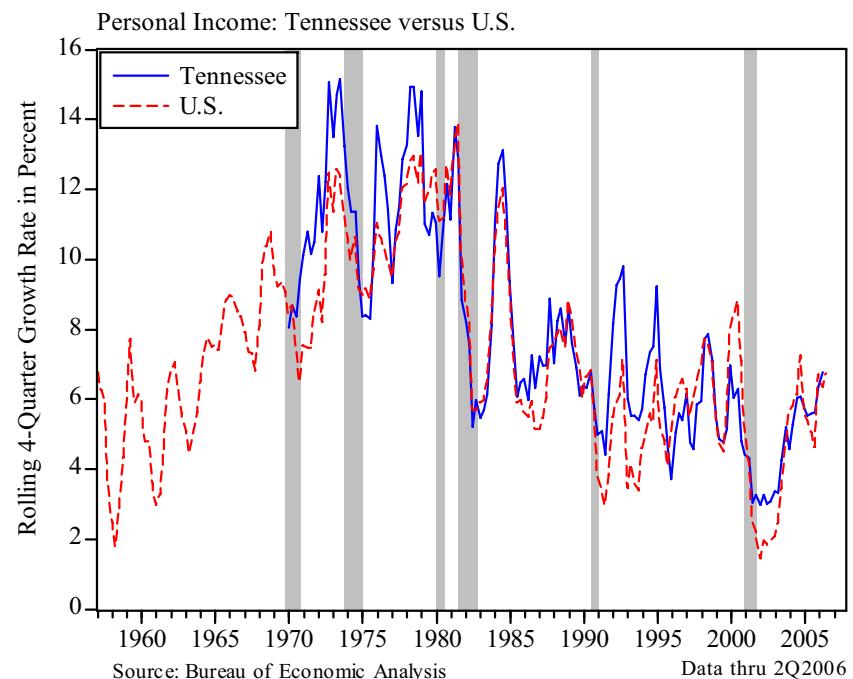
Quarterly growth in state and nation follows roughly the same cyclical pattern

- Over time, each 1% growth in U.S. personal income is met with 1% growth in Tennessee
- Admittedly, there are sizeable short-run deviations between the two

At this point in the current expansion, the rolling four-quarter growth of personal income for Tennessee is tracking the U.S. pattern

However, in the early days of the expansion, Tennessee's growth was lower than that of the U.S.

This shortfall in times of slow U.S. growth is consistent with past patterns



The Tennessee Cycle in Perspective

Labor Markets – Tennessee versus U.S.

Tennessee's growth pattern moves in a roughly similar cyclical pattern

But, differences are evident

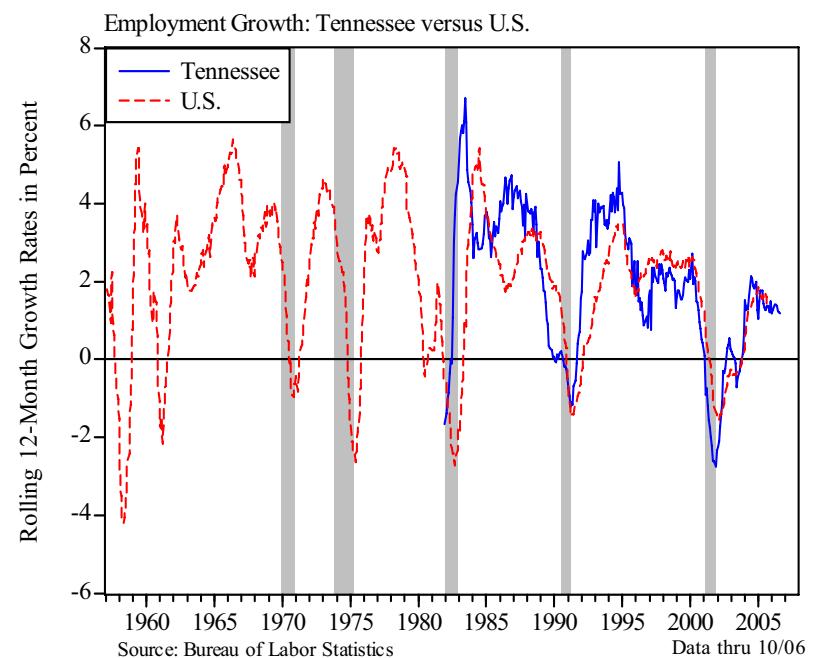
Pattern has tighter co-movement as decline gathers momentum

In the early part of the common sample period, Tennessee typically had a stronger employment growth than the country as a whole in the upswing

But Tennessee and U.S. are moving into closer cyclical alignment in the past 10 years

More recently, a mild deceleration in U.S. employment growth is evident

Tennessee, in contrast, has exhibited less of a moderating wiggle



The Tennessee Cycle in Perspective

Housing Activity – Tennessee versus U.S.

Housing in Tennessee generally moves with the U.S. housing cycle

- For 2004 and 2005, housing in Tennessee is in line with U.S. activity
- The relationship was at a weaker level than in the 1992-1999 period

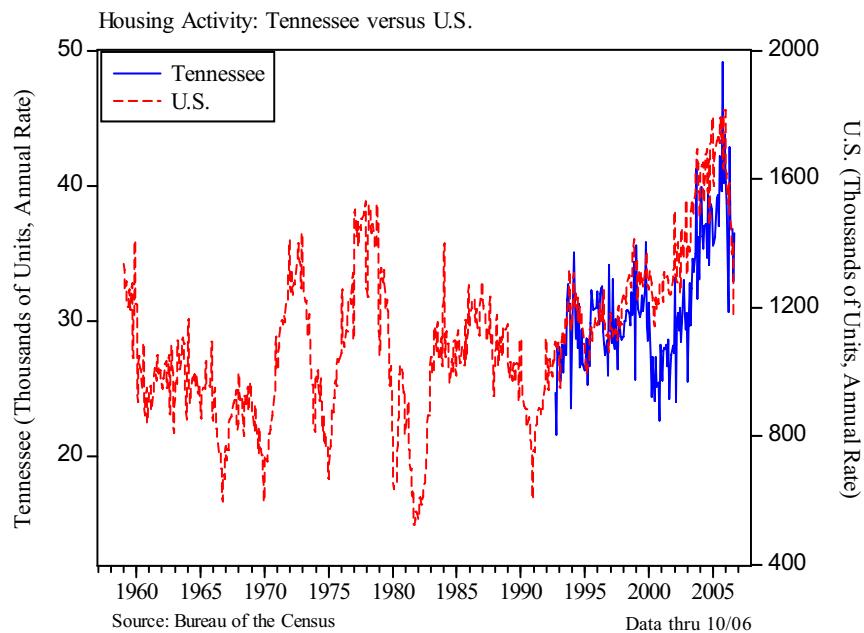
So far in 2006, relationship between Tennessee and the U.S. has been tight

Because of recent strength, some see the housing boom as a potential bubble

- If so, both the volume of permits and valuation could be at risk

Housing in Tennessee is more volatile than in the U.S.

- Expansion in Tennessee and the U.S. seem to move together
- Downturn is more severe in Tennessee than the country as a whole



The Tennessee Cycle in Perspective

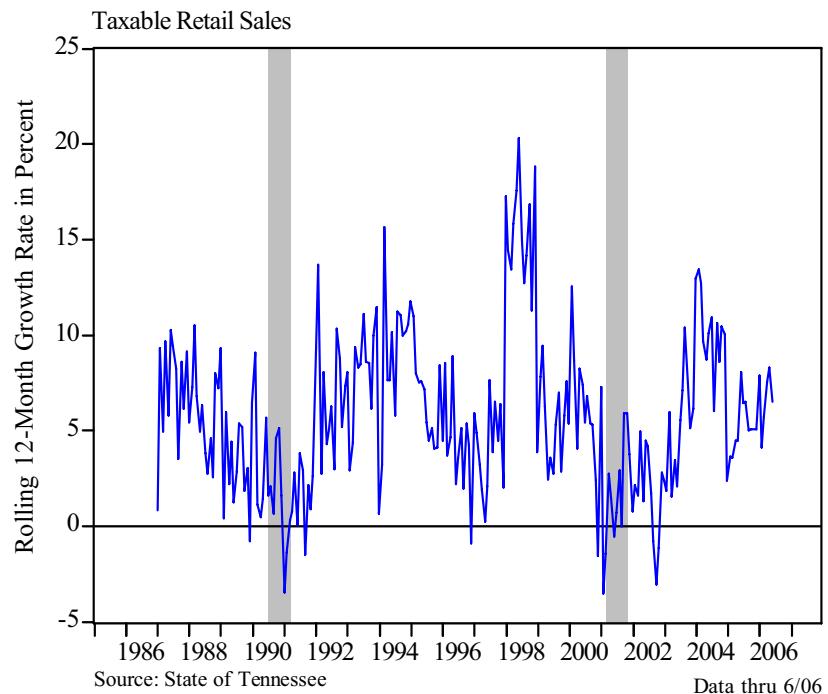
Consumer Spending

Pattern of slower growth after the 1990 recession was repeated after the 2001 recession, but for a longer time

In both cases, growth eventually accelerated
However, recent growth is a bit slower than a few years ago

Since inflation is lower, real growth is stronger in this expansion than the last one

Problem: pace of nominal sales growth determines the support that spending provides to sales tax growth



Baseline Tennessee Outlook

Table 8

	2006				2007				2008				Year-over-Year Growth
	I(A) 2006	II(A) 2006	III(A) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	I(E) 2008	II(E) 2008	III(E) 2008	IV(E) 2008	2006 2007 2008
National Trends													
1 Civilian Employment (Mil.)	143.3	144.0	144.6	145.0	145.4	145.9	146.2	146.6	147.0	147.5	148.0	148.5	1.8
2 Change *	1.8	1.9	1.6	1.2	1.2	1.2	1.1	1.0	1.2	1.2	1.3	1.4	1.2
3 Personal Income	10721.4	10807.3	10954.0	11023.3	11161.7	11278.9	11409.4	11549.6	11704.3	11862.9	12020.0	12202.1	6.3
4 Change *	9.4	3.2	5.5	3.6	4.0	4.3	4.7	5.0	5.5	5.7	5.9	6.1	5.3
5 Income Per Employee (T)	74,805	75,046	75,761	76,213	76,746	77,330	78,015	78,772	79,598	80,429	81,292	82,175	4.4
6 Housing Starts (Mil. of Units)	2,123	1,873	1,720	1,462	1,505	1,506	1,565	1,706	1,752	1,813	1,875	-13.5	-13.2
7 Change *	12.9	-39.5	-28.9	-47.8	12.5	0.3	16.5	25.5	12.5	11.3	14.7	14.7	14.7
Tennessee													
9 Nonagricultural Employment (T)	2761.9	2780.3	2780.2	2787.0	2794.2	2800.9	2807.9	2814.9	2822.4	2829.8	2837.2	2838.0	1.2
10 Change *	0.5	2.7	0.0	1.0	1.0	1.0	1.0	1.1	1.1	1.0	0.1	1.0	1.0
11 Personal Income	191.8	195.3	197.8	199.6	201.7	203.9	206.3	208.8	211.6	214.5	217.5	220.4	6.2
12 Change *	5.7	7.5	5.2	3.8	4.2	4.4	4.8	5.1	5.5	5.7	5.7	5.5	5.3
13 Dividends & Interest	22.3	22.9	23.3	23.6	23.8	23.9	24.1	24.4	24.6	24.8	25.0	25.2	7.6
14 Change *	2.8	12.1	7.2	4.3	3.5	3.3	3.4	3.4	3.6	3.6	3.7	3.8	3.5
15 Income Per Employee (T)	69,435	70,232	71,128	71,625	72,176	72,780	73,454	74,182	74,978	75,794	76,649	77,668	5.0
16 Change *	5.2	4.7	5.2	2.8	3.1	3.4	3.8	4.0	4.4	4.6	5.4	5.4	4.3
17 Retail Sales	82.6	85.6	85.9	86.9	87.6	88.5	89.4	90.4	91.5	92.6	93.8	95.0	6.2
18 Change *	3.5	15.0	1.5	4.7	3.3	4.1	4.2	4.6	4.9	5.0	5.1	5.0	4.8
19 Single-Family Building Permits (T)	40,901	36,790	35,506	36,213	34,094	34,146	34,673	35,771	35,831	36,310	37,032	37,744	6.0
20 Change *	-17.9	-34.5	-13.2	8.2	-21.4	0.6	6.3	12.5	1.3	5.3	8.3	7.9	-7.2

Note: Except where noted, all data in billions of dollars. Historic sources: BEA, BLS, State of Tennessee

*Thousands of units, persons, or dollars

*Quarter-to-quarter percent changes expressed at compound annual rates.

A = Actual, E = Forecast

Prospects for Tax Revenue: Funding Board Estimates

Table 9

	FY96-97	FY97-98	FY98-99	FY99-00	FY00-01	FY01-02	FY02-03	FY03-04	FY04-05	FY05-06	Forecasts	FY06-07	FY07-08	FY08-09
1 Total Tax Revenue*	6415.1	6791.0	7030.3	7558.5	7636.3	7508.6	8505.3	9121.0	9665.6	10332.4	10674.3	6.9	3.3	
2 Chg @	5.7	5.9	3.5	7.5	1.0	-1.7	13.3	7.2	6.0					
3 Sales and Use Tax*	3906.7	4102.7	4337.3	4608.3	4642.7	4634.7	5455.2	5806.5	6094.4	6521.9	6805.3	4.3	4.3	
4 Chg @	6.3	5.0	5.7	6.2	0.7	0.3	17.2	6.4	5.0					
5 Income Tax*	128.9	160.4	160.6	180.2	198.6	144.5	116.8	139.8	155.4	193.1	203.5			
6 Chg @	12.6	24.5	0.1	12.2	10.2	-27.2	-19.2	19.7	11.2	24.3	5.4			
7 Gross Receipts Tax*	189.0	188.4	199.3	213.5	216.8	223.9	218.6	235.0	241.2	249.8				
8 Chg @	7.4	-0.3	5.8	7.1	1.5	3.3	-3.4	1.1	7.5	2.6	3.6			
9 Excise plus Franchise Taxes*	888.5	913.8	893.4	1074.3	1112.1	968.4	1085.0	1181.9	1367.4	1493.0	1531.0			
10 Chg @	8.9	2.8	-2.2	20.3	3.5	12.0	8.9	15.7	9.3	2.4				
11 Gasoline Tax*	543.3	563.2	567.9	576.6	569.4	576.9	600.9	608.1	605.6	597.0				
12 Chg @	1.4	3.7	0.8	1.5	-1.3	1.3	4.2	0.0	1.2	-0.4	-1.4			
13 Vehicle Registration*	184.2	196.5	201.5	219.3	212.1	221.2	226.8	240.5	246.3	251.6	265.0			
14 Chg @	-0.5	6.6	2.6	8.8	-3.3	4.3	2.5	6.0	2.4	2.2	1.3			
15 Fuel Tax*	126.8	133.2	142.5	152.8	146.8	151.2	154.8	168.8	173.3	181.2	184.3			
16 Chg @	0.1	7.2	-3.2	9.0	2.4	9.0	4.6	7.7						
17 Privilege Tax*	150.7	171.0	191.9	186.6	190.1	207.9	248.6	276.9	294.1	333.7	339.9			
18 Chg @	7.8	13.4	-2.8	1.9	9.4	19.6	11.4	6.2	14.1	14.1	1.3			
19 All Other Taxes*	296.8	361.8	335.9	346.9	359.9	401.0	487.2	491.6	508.9	508.5	530.4			
20 Chg @	-2.3	21.9	-7.2	3.3	3.5	11.4	21.5	0.9	3.1	3.1	0.3			

Prospects for Tax Revenue: MTSU Forecast

Table 10

Tennessee Economic Assumptions (Fiscal-Year Basis)	FY96-97	FY97-98	FY98-99	FY99-00	FY00-01	FY01-02	FY02-03	FY03-04	FY04-05	FY05-06	Forecasts	FY06-07	FY07-08	FY08-09
1 Personal Income (Bl \$)	121.6	128.9	137.0	144.9	152.0	156.8	161.8	169.7	179.6	190.5	200.7	210.3	222.1	
2 Chg @	5.5	6.0	6.3	4.9	3.1	3.2	4.8	5.8	6.1	5.4	4.8	5.6	5.6	
3 Nonagricultural Employment (Mil)	2.6	2.6	2.7	2.7	2.7	2.7	2.7	2.7	2.8	2.8	2.8	2.8	2.8	
4 Chg @	1.4	2.1	1.9	2.1	0.2	-2.1	0.1	0.5	1.7	1.3	1.0	1.0	0.9	
5 Income Per Employee (Th \$)	47.6	49.4	51.5	53.4	55.9	58.9	60.7	63.3	65.9	69.0	71.9	74.6	78.1	
6 Chg @	4.0	3.8	4.4	5.3	3.1	4.3	4.1	4.7	4.3	3.7				
7 Retail Sales (Bill \$)	48.3	53.5	58.8	62.6	64.1	65.9	67.0	73.1	78.1	82.9	87.2	91.0	95.6	
8 Chg @	3.1	10.8	9.9	6.5	2.4	2.9	1.7	9.1	6.8	6.1	5.2	4.3	3.9	
9 Building Permits (Th of Units)	29.2	31.2	29.4	26.3	28.0	30.2	36.0	37.2	40.2	35.0	35.6	37.9	37.9	
10 Chg @	-6.8	0.7	6.0	-4.7	-11.4	6.4	8.0	19.0	3.4	8.0	-13.0	1.8	6.5	
Revenue Forecasts														
	FY98-97	FY97-98	FY98-99	FY99-00	FY00-01	FY01-02	FY02-03	FY03-04	FY04-05	FY05-06	Forecasts	FY06-07	FY07-08	FY08-09
11 Total Tax Revenue*	6415.1	6791.0	7030.3	7558.5	7636.3	7508.6	8505.3	9121.0	9665.6	10332.4	10674.3			
12 Chg @	5.7	5.9	3.5	7.5	1.0	-1.7	13.3	7.2	6.0	3.9	3.2	4.2		
13 Sales and Use Tax*	3906.7	4102.7	4337.3	4608.3	4642.7	4634.7	5455.2	5806.5	6094.4	6521.9	6805.3			
14 Chg @	6.3	5.0	5.7	6.2	0.7	0.3	17.2	6.4	5.0	4.3	3.2	4.3		
15 Income Tax*	128.9	160.4	160.6	180.2	198.6	144.5	116.8	139.8	155.4	193.1	219.4	241.3	265.9	
16 Chg @	12.6	24.5	0.1	10.2	-27.2	-19.2	12.0	11.2	24.3	10.2	10.2			
17 Gross Receipts Tax*	189.0	188.4	199.3	213.5	216.8	223.9	218.6	235.0	241.2	245.9	249.9	255.2		
18 Chg @	7.4	-0.3	5.8	7.1	1.5	3.3	-3.4	1.1	7.5	2.6	1.9	2.1		
19 Excise plus Franchise Taxes*	888.5	913.8	893.4	1074.3	1112.1	968.4	1085.0	1181.9	1367.4	1495.0	1567.5	1617.9	1688.8	
20 Chg @	8.9	2.8	-2.2	20.3	3.5	-12.9	12.0	8.9	15.7	9.3	4.8	3.2	5.0	
21 Gasoline Tax*	543.3	563.2	567.9	576.6	569.4	576.9	600.9	600.9	608.1	605.6	599.0	618.1		
22 Chg @	3.7	0.8	1.5	-1.3	4.2	0.2	1.2	-0.4	-1.1	1.0				
23 Vehicle Registration*	184.2	196.5	201.5	219.3	212.1	221.2	226.8	240.5	246.3	251.6	256.3	259.8	263.0	
24 Chg @	-0.5	6.6	2.6	8.8	-3.3	4.3	2.5	6.0	2.4	2.2	1.8	1.4	1.2	
25 Fuel Tax*	126.8	133.2	142.5	152.8	148.0	151.2	154.8	168.8	173.3	186.5	192.9	198.3	203.3	
26 Chg @	0.1	7.0	7.2	-3.9	3.0	2.4	2.7	4.6	2.9	3.4	3.4	3.3		
27 Privilege Tax*	150.7	171.0	191.9	186.6	190.1	207.9	248.6	276.9	294.1	333.7	341.8	360.8	380.0	
28 Chg @	7.8	13.4	12.2	-2.8	9.4	11.4	14.1	14.1	14.1	14.1				
29 All Other Taxes*	296.8	361.8	335.9	346.9	359.9	401.0	487.2	491.6	508.9	508.5	530.4	544.3		
30 Chg @	-2.3	21.9	-7.2	3.3	3.5	11.4	21.5	0.9	3.1	2.3	2.3			

* Millions of dollars @ Annual Percent Change

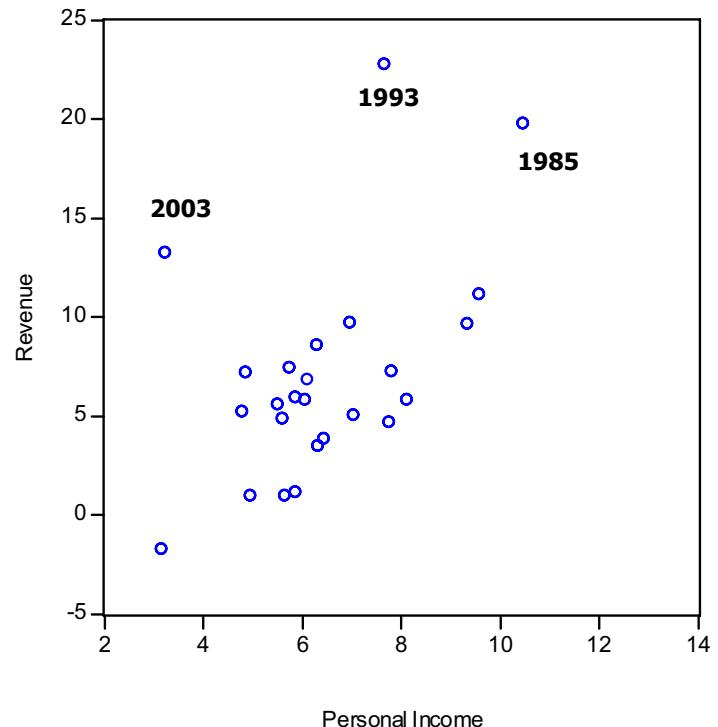
Annual economic data in lines 1, 3, 5, 7, and 9 are calculated in terms of fiscal years ending in 1Q of the calendar year of the noted fiscal year

A Consistency Check

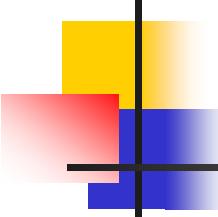
Top-down forecasting model projects growth in tax revenue based on personal income growth, controlling for tax rate changes in 1985, 1993, and 2003

Based on personal income projections, the consistency check is below

Growth is stronger on the consistency model, probably due to the lower income elasticity of the items other than sales tax in the baseline forecast



	2006	2007	2008	2009	2010
Revenue Growth	6.90	4.62	3.68	3.76	3.71
Revenue (thousand of \$)	\$10,332,386	\$10,810,100	\$11,207,770	\$11,628,890	\$12,060,460



Contingency Views

Balancing the Risks

Probabilities

- Stronger growth 25%
- Baseline 50%
- Weaker growth 25%

Tilting the balance to weak-growth scenario: Asymmetric cost of forecast errors

- Lower than projected tax revenue is a bigger problem for the state than higher than projected tax revenue

Risk scenario

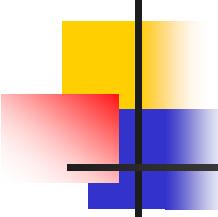
Faltering U.S. growth with spillover effects to Tennessee

Personal income growth in Tennessee is roughly 2.5% less per year than in the baseline forecast

Employment growth is roughly one-half the pace projected in the baseline

An additional half percent “haircut” incorporated to account for reduced elasticity in times of stress Results for this risk scenario, using the consistency model, is reported below

	2006	2007	2008	2009	2010
Revenue Growth	6.90	3.55	2.21	2.14	2.03
Revenue (millions of \$)	\$10,332,386	\$10,699,430	\$10,935,570	\$11,169,140	\$11,396,280



The U.S. Outlook – Problem Areas

Monitoring the Likelihood of Weaker Than Projected Growth

Winning the peace

- Uncertainty over the situation in Iraq remains
- Nuclear programs in North Korea and Iran complicate the situation

Global growth

- On the positive side, Japan has emerged from its long deflationary recession

Pricing power

- Some signs that inflation may be entrenching itself
- Effort to hold the line on inflation may again be placing most of the adjustment pressure in the goods-producing sectors
- Possible conflict between new congress and the new Federal Reserve chairman

Sector problems

- Housing and vehicle sales fallen faster than most expected as the interest rates moved toward current levels

Energy

- Oil likely to stay above \$60 with jumps toward \$70
- OPEC pricing partly influence by threshold price of tar sand and shale oil

Interest Rate Cycle and the Yield Curve

- Downward sloping yield curve has been harbinger of a recession
- Information content may be less reliable now
 - Hedge funds may contribute to volatility
 - Shifts in foreign demand could affect long-term yields
 - Softening on inflation by Bernanke, in response to pressure, could have adverse effect on long-term yields

The dollar in international currency markets

- Trade deficit is wide and is unlikely to narrow without a large jump in export growth and a sharp narrowing of import growth
- Private foreign appetite for dollar instruments is weakening
- Capital inflow through official foreign institutions remain important
- China is allowing a grudging appreciation of its currency
- But, China is still heavy purchaser of dollar assets given its sizeable trade surplus with the U.S.
- China and other have begun diversify is foreign reserve holding